FILED

95 • 554 OCT 3 - 1995

OFFICE OF THE CLERK

No. 95-———

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

ROBERT W. SCARTH, *et al.*,
Petitioners,

v.

NICOR EXPLORATION COMPANY,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

BERNARD A. FOSTER, III
Counsel of Record
WILLIAM R. MAPES, JR.
G. WILLIAM STAFFORD
DEBORAH A. CARPENTIER
ROSS, MARSH & FOSTER
1401 H Street, N.W.
Washington, D.C. 20005-2110
(202) 822-8888
Counsel for Petitioners

October 3, 1995

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

181 pp

QUESTIONS PRESENTED

In 1980 the Federal Energy Regulatory Commission ("FERC" or "Commission") filled a legislative gap created by the Natural Gas Policy Act of 1978 ("NGPA") and established rules for interpreting whether gas contract price escalation provisions allow price levels permitted by that statute. In the case below, the Fifth Circuit held that it need not grant deference to FERC's rules or their application, but could consider the contract interpretation issue "*de novo.*" The Fifth Circuit's decision is in direct conflict with other circuit Courts of Appeal that, in accord with *Chevron, U.S.A., Inc. v. NRDC*, 467 U.S. 837 (1984), give deference to agency contract interpretation. The Fifth Circuit's decision raises the following significant questions:

1. Whether a court, in reviewing agency rules for interpreting contractual language that is subject to and developed to comply with the agency's regulations under its enabling statutes, owes deference to such agency's rules and interpretation?

2. Whether a reviewing court is bound by and must defer to an agency's inferences of fact and regulatory presumptions if they are supported by substantial evidence?

3. Whether the Fifth Circuit's judgment was clearly erroneous in its application of Oklahoma law because it directly conflicts with and plainly fails to follow the requirements of Oklahoma law?

4. Whether, after reversing an agency based upon errors of law, a reviewing court can, on remand, direct the agency's exercise of its discretion under its enabling statutes?

LIST OF PARTIES

The following are the Petitioners in this case, and are referred to in this Petition as "Robert W. Scarth, *et al.*" or "Scarth":

Robert W. Scarth (successor to Scarth Oil & Gas Company) and on behalf of the following other working interest owners in the Green Well:

Mitchell Energy Corporation
A.L. Park
David Dean
Leon M. Grandcolas and Rita M. Grandcolas Trustees of the Grandcolas Family 1991 Revocable Trust
Doug Hershey
Robert Lee, Jr.
Dorsey Schad
Charles Sweeney
Kay Fancher
Jerry Haggard
Stephen Johnes
Bill Logsdon
Ed Naslund
Virgil Scarth
Jane Schuebell.

The following were parties to the proceedings before the court whose judgment is sought to be reviewed:

Robert W. Scarth, *et al.*;
NICOR Exploration Company; and
Federal Energy Regulatory Commission.

The parent company of Mitchell Energy Corporation is MND Energy Corporation. The parent company of MND Energy Corporation is Mitchell Energy & Development Corp. Mitchell Energy Corporation has no non-wholly owned subsidiaries.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
LIST OF PARTIES	ii
TABLE OF AUTHORITIES	vii
OPINIONS AND ORDERS BELOW	1
JURISDICTION	1
STATUTES AND REGULATIONS	1
STATEMENT OF THE CASE	2
REASONS FOR GRANTING THE WRIT	4
I. *NICOR* WAS DECIDED IN CONFLICT WITH *CHEVRON* WHICH REQUIRES DEFERENCE TO FERC'S RULES IMPLEMENTING ITS ENABLING STATUTES	4
II. THIS COURT SHOULD RESOLVE THE CLEAR CONFLICT AMONG CIRCUITS CONCERNING DEFERENCE TO AGENCY INTERPRETATIONS OF CONTRACTUAL LANGUAGE SUBJECT TO AND DEVELOPED TO COMPLY WITH AGENCY REGULATIONS	9
A. *NICOR* Directly Conflicts With Other Circuits	9
B. *Certiorari* Is Appropriate To Resolve The Foregoing Conflict Among Circuits	12
III. *NICOR* CONFLICTS WITH THIS COURT'S DECISIONS THAT REQUIRE AFFIRMANCE OF AGENCY FACTUAL INFERENCES THAT ARE SUPPORTED BY SUBSTANTIAL EVIDENCE	13
A. There Was No Requisite Finding That FERC's Opinion 77 Factual Inferences Were Not Based On Substantial Evidence	13

TABLE OF CONTENTS—Continued

Page

B. The Court Also Relied Upon Invalid Factual Findings Contrary To The Substantial Evidence Test 20

IV. *NICOR* WAS DECIDED IN CONFLICT WITH THIS COURT'S DECISIONS CONCERNING AN AGENCY'S USE OF PRESUMPTIONS AND THEIR SCOPE OF REVIEW 22

V. THIS COURT SHOULD EXERCISE ITS SUPERVISORY POWERS BECAUSE *NICOR* FAILS TO APPLY OKLAHOMA LAW AND IS CLEARLY CONTRARY TO DECISIONS OF OKLAHOMA'S COURTS 25

VI. *NICOR* CONFLICTS WITH THIS COURT'S DECISIONS CONCERNING THE SCOPE OF AGENCY AUTHORITY UPON REMAND 29

CONCLUSION 30

APPENDIX A

Decision of the Court of Appeals in *NICOR Exploration Company v. Federal Energy Regulatory Commission*, No. 94-40246, dated April 27, 1995 .... 1a

APPENDIX B

"Initial Decision" of the Administrative Law Judge in *NICOR Exploration Company*, FERC Docket No. GP90-11-000, dated September 24, 1991 ..... 15a

The "Order Affirming Initial Decision" of the Federal Energy Regulatory Commission in *NICOR Exploration Company*, FERC Docket No. GP90-11-000, dated February 21, 1992 ..... 32a

The "Order Granting Rehearing in Part" of the Federal Energy Regulatory Commission in *NICOR Exploration Company*, FERC Docket No. GP90-11-001, dated April 7, 1993 ..... 54a

TABLE OF CONTENTS—Continued

Page

The "Order Denying Rehearing" of the Federal Energy Regulatory Commission in *NICOR Exploration Company*, FERC Docket No. GP90-11-002, dated March 2, 1994 ..... 76a

APPENDIX C

NICOR Exploration Company v. Federal Energy Regulatory Commission, No. 94-40246, "On Petition for Rehearing and Suggestion for Rehearing En Banc" (5th Cir. Jul. 5, 1995) 100a

APPENDIX D

Natural Gas Act

§ 4, 15 U.S.C. § 717c(a), (c), (e) 101a
§ 5, 15 U.S.C. § 717d(a) 103a
§ 19, 15 U.S.C. § 717r(b) 103a

Natural Gas Policy Act

§ 2, 15 U.S.C. § 3301(11)-(14) 105a
§ 101, 15 U.S.C. § 3311(b)(5), (9) 106a
§ 104, 15 U.S.C. § 3314 ..... 106a
§ 108, 15 U.S.C. § 3318 ..... 108a
§ 506, 15 U.S.C. § 3416(a)(4) 110a
§ 601, 15 U.S.C. § 3431(b)(1)(A) 111a

Okla. Stat. Ann. tit. 12, § 577.1 ..... 113a
Okla. Stat. Ann. tit. 12, § 577.2 ..... 113a
Okla. Stat. Ann. tit. 12, § 2301 ..... 114a
Okla. Stat. Ann. tit. 12, § 2302 ..... 114a
Okla. Stat. Ann. tit. 12, § 2303 ..... 114a
Okla. Stat. Ann. tit. 15, § 151 ..... 116a
Okla. Stat. Ann. tit. 15, § 152 ..... 116a
Okla. Stat. Ann. tit. 15, § 153 ..... 116a
Okla. Stat. Ann. tit. 15, § 154 ..... 116a
Okla. Stat. Ann. tit. 15, § 155 ..... 116a
Okla. Stat. Ann. tit. 15, § 156 ..... 116a
Okla. Stat. Ann. tit. 15, § 157 ..... 117a
Okla. Stat. Ann. tit. 15, § 158 ..... 117a
Okla. Stat. Ann. tit. 15, § 159 ..... 117a

TABLE OF CONTENTS—Continued

	Page
Okla. Stat. Ann. tit. 15, § 160	117a
Okla. Stat. Ann. tit. 15, § 161	117a
Okla. Stat. Ann. tit. 15, § 162	117a
Okla. Stat. Ann. tit. 15, § 163	118a
Okla. Stat. Ann. tit. 15, § 164	118a
Okla. Stat. Ann. tit. 15, § 165	118a
Okla. Stat. Ann. tit. 15, § 166	118a
Okla. Stat. Ann. tit. 15, § 167	118a
Okla. Stat. Ann. tit. 15, § 168	118a
Okla. Stat. Ann. tit. 15, § 169	119a
Okla. Stat. Ann. tit. 15, § 170	119a
Okla. Stat. Ann. tit. 15, § 171	119a
Okla. Stat. Ann. tit. 15, § 172	119a
Okla. Stat. Ann. tit. 15, § 173	119a
Okla. Stat. Ann. tit. 15, § 174	120a
Okla. Stat. Ann. tit. 15, § 175	120a
Okla. Stat. Ann. tit. 15, § 176	120a
Okla. Stat. Ann. tit. 15, § 177	120a
Regulations of the Federal Energy Regulatory Commission	
18 C.F.R. § 154.93 *	121a
18 U.S.C. § 270.205(a) *	122a
Federal Rule of Evidence 301	123a
Federal Rule of Evidence 302	123a
APPENDIX E	
Portions of GHK Contract	124a
Portions of Sun Oil Company Contract	125a
Portions of Amerada Hess Contract	126a
Oklahoma Uniform Jury Instructions: Civil (Second Edition)	127a

---

* This regulation was removed from FERC's regulations. *Removal of Outdated Regulations Pertaining to the Sales of Natural Gas Production*, Order No. 567, III F.E.R.C. Stats. & Regs. (CCH) ¶ 30,999 (1994).

TABLE OF AUTHORITIES

UNITED STATES SUPREME COURT CASES	Page
Aldinger v. Howard, 427 U.S. 1 (1976)	12
Arkansas v. Oklahoma, 503 U.S. 91 (1992)	21
Basic Inc. v. Levinson, 485 U.S. 224 (1988)	23
Beth Israel Hospital v. NLRB, 437 U.S. 483 (1978)	22
Brockett v. Spokane Arcades, Inc., 472 U.S. 491 (1985)	25
Chemical Mfrs. Ass'n v. NRDC, 470 U.S. 116 (1985)	12
Chevron, U.S.A., Inc. v. NRDC, 467 U.S. 837 (1984)	*passim*
Consolo v. Federal Maritime Comm'n, 383 U.S. 607 (1966)	21
Energy Reserves Group, Inc. v. Kansas Power & Light Co., 459 U.S. 400 (1983)	19-20
FPC v. Idaho Power Co., 344 U.S. 17 (1952)	30
FPC v. Texaco, Inc., 377 U.S. 33 (1964)	6
FTC v. Indiana Fed'n of Dentists, 476 U.S. 447 (1986)	21
FTC v. Pacific States Paper Trade Ass'n, 273 U.S. 52 (1927)	16
Illinois Cent. R. v. Norfolk & W. Ry., 385 U.S. 57 (1966)	16
Lehman v. Lycoming County Children's Serv., 458 U.S. 502 (1982)	12
Mobil Oil Corp. v. FPC, 417 U.S. 283 (1974)	13
NLRB v. Baptist Hospital, Inc., 442 U.S. 773 (1979)	22
NLRB v. Curtin Matheson Scientific, Inc., 494 U.S. 775 (1990)	16
Pauley v. Bethenergy Mines, Inc., 501 U.S. 680 (1991)	7
Permian Basin Area Rate Cases, 390 U.S. 747 (1968)	22
Public Serv. Comm'n of N.Y. v. Mid-Louisiana Gas Co., 463 U.S. 319 (1983)	2
Texas Dep't of Comm. Affairs v. Burdine, 450 U.S. 248 (1981)	25
Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Bd. of Miss., 474 U.S. 409 (1986)	5

TABLE OF AUTHORITIES—Continued

Page

United Gas Improvement Co. v. Continental Oil Co., 381 U.S. 392 (1965) 30
United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div., 358 U.S. 103 (1958) 5
United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956) 5

FEDERAL CASES

Amoco Prod. Co. v. FERC, 765 F.2d 686 (7th Cir. 1985) 12
Bullion v. FDIC, 881 F.2d 1368 (5th Cir. 1989) 21
Cia Mexicana De Gas v. FPC, 167 F.2d 804 (5th Cir. 1948) 21-22
Coca-Cola Co. v. Atchinson, T. & S.F. Ry., 608 F.2d 213 (5th Cir. 1979) 10
Cole v. U.S. Dep't of Agric., 33 F.3d 1263 (11th Cir. 1994), *cert. denied*, 115 S. Ct. 1956 (1995) 22
Consolidated Gas Supply Corp. v. FERC, 745 F.2d 281 (4th Cir. 1984), *cert. denied*, 472 U.S. 1008 (1985) 11
Electromation, Inc. v. NLRB, 35 F.3d 1148 (7th Cir. 1994) 12
First Indep. Group, Inc. v. SEC, 37 F.3d 30 (2d Cir. 1994) 12
Fritz v. FERC, 876 F.2d 1224 (5th Cir. 1989) 6
Higgins v. SEC, 866 F.2d 47 (2d Cir. 1989) 12
National Fuel Gas Supply Corp. v. FERC, 811 F.2d 1563 (D.C. Cir. 1987), *cert. denied*, 484 U.S. 869 (1987) 10-12
Natural Gas Clearinghouse v. FERC, 965 F.2d 1066 (D.C. Cir. 1992) 10
NICOR Exploration Co., 50 F.3d 1341 (5th Cir. 1995) ..... *passim*
NLRB v. Augusta Bakery Corp., 957 F.2d 1467 (7th Cir. 1992) 12
NLRB v. Brooks Cameras, Inc., 691 F.2d 912 (9th Cir. 1982) 21
Northwest Pipeline Corp. v. FERC, 61 F.3d 1479 (10th Cir. 1995) 9, 10, 12

TABLE OF AUTHORITIES—Continued

Page

Nueces County Navig. Dist. No. 1 v. ICC, 674 F.2d 1055 (5th Cir.), *cert. denied*, 459 U.S. 1035 (1982) 16

Pacific Gas & Elec. Co. v. FERC, 746 F.2d 1383 (9th Cir. 1984) 12

Pennzoil Co. v. FERC, 645 F.2d 360 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982) 3, 6, 17, 20

Pennzoil Co. v. FERC, 671 F.2d 119 (5th Cir. Unit A 1982) 9

Rideau v. Parkem Industrial Services, 917 F.2d 892 (5th Cir. 1990) 16, 17

Superior Oil Co. v. FERC, 569 F.2d 971 (5th Cir.), *cert. denied*, 439 U.S. 834 (1978) 9

Tarpon Transmission Co. v. FERC, 860 F.2d 439 (D.C. Cir. 1988) 10

Williams Natural Gas Co. v. FERC, 3 F.3d 1544 (D.C. Cir. 1993) 10, 12

STATE COURT DECISIONS

Beck v. Traders & General Ins. Co., 77 P.2d 109 (Okla. 1938) 27

Bonner v. Oklahoma Rock Corp., 863 P.2d 1176 (Okla. 1993) 28, 29

Brown v. Oklahoma Transp. Co., 588 P.2d 595 (Okla. Ct. App. 1978) 24

C.I.T. Corp. v. Edwards, 418 P.2d 685 (Okla. 1966) 17

Dismuke v. Cseh, 830 P.2d 188 (Okla. 1992) 27, 28

Iron Mountain Oil Co. v. Edwards, 100 Okla. 4, 227 P. 150 (1924) 27

Morrow v. Morrow, 612 P.2d 730 (Okla. Ct. App. 1980) 26, 28

Nanonka v. Nanonka, 645 P.2d 507 (Okla. 1982) 24

Oklahoma Civil Jury Instructions, SCAD 93-3 (Okla. Feb. 26, 1993) 26

Rain v. Balph, 293 P.2d 359 (Okla. 1956) 27, 28

ADMINISTRATIVE CASES

Colorado Interstate Gas Co., 44 F.E.R.C. (CCH) ¶ 61,023 (1988) 7

Equitable Gas Co., 23 F.E.R.C. (CCH) ¶ 61,015 (1983) 7

TABLE OF AUTHORITIES—Continued

Page

Independent Oil & Gas Ass'n of W. Va., Opinion No. 77, 10 F.E.R.C. (CCH) ¶ 61,214 (1980) ....*passim*

NICOR Expl. Co., "Initial Decision," 56 F.E.R.C. (CCH) ¶ 63,023 (1991) (App. 15a-31a) 1, 4

NICOR Expl. Co., "Order Affirming Initial Decision," 58 F.E.R.C. (CCH) ¶ 61,203 (1992) (App. 32a-53a) 1, 4

NICOR Expl. Co., "Order Granting Rehearing in part," 63 F.E.R.C. (CCH) ¶ 61,034 (1993) (App. 54a-75a) .....*passim*

NICOR Expl. Co., "Order Denying Rehearing," 66 F.E.R.C. (CCH) ¶ 61,276 (1994) (App. 76a-99a) .....*passim*

Oklahoma Natural Gas Gathering Co., 23 F.E.R.C. (CCH) ¶ 61,308 (1983) 7

Final Regulations Amending and Clarifying Regulations under the Natural Gas Policy Act and the Natural Gas Act, Order No. 23, 1977-1981 F.E.R.C. Stats. & Regs., Regs. Preambles (CCH) ¶ 30,040 (1979) .....*passim*

Removal of Outdated Regulations Pertaining to the Sales of Natural Gas Production, Order No. 567, III F.E.R.C. Stats. & Regs. (CCH) ¶ 30,999 (1994) 2, 121a

Order 242, 27 F.P.C. 339 (1962) 6

STATUTES

Natural Gas Act

§ 4, 15 U.S.C. § 717c 1

§ 5, 15 U.S.C. § 717d 1

§ 16, 15 U.S.C. § 717*o* 8

§ 19(b), 15 U.S.C. § 717r(b) 1, 2, 13, 27

Natural Gas Policy Act

§ 2(11)-(14), 15 U.S.C. § 3301(11)-(14) 1-2

§ 101(b)(5), 15 U.S.C. § 3311(b)(5) 1-2

§ 101(b)(9), 15 U.S.C. § 3311(b)(9) 1-2, 6

§ 104, 15 U.S.C. § 3314 1-2

§ 108, 15 U.S.C. § 3318 .....*passim*

§ 501, 15 U.S.C. § 3411 8

TABLE OF AUTHORITIES—Continued

	Page
§ 506(a)(4), 15 U.S.C. § 3416(a)(4)	1-2, 13, 27
§ 601(b)(1)(A), 15 U.S.C. § 3431(b)(1)(A) (*subsequently amended by* 15 U.S.C. § 3431 b(1)(A) (1989))	1-2, 20
28 U.S.C. § 1254(1)	1
Federal Rules of Evidence	
Fed. R. Evid. 301	24
Fed. R. Evid. 302	24
Rules of the Supreme Court of the United States	
Sup. Ct. R. 10	25
Oklahoma Statutes	
Okla. Stat. Ann. tit. 12, §§ 577.1 (West 1993)	2, 26
Okla. Stat. Ann. tit. 12, §§ 577.2	2, 26
Okla. Stat. Ann. tit. 12, §§ 2301-2303	2, 24
Okla. Stat. Ann. tit. 15, § 151-177 (West 1993)	2, 27
Okla. Stat. Ann. tit. 15, § 157	29
Okla. Stat. Ann. tit. 15, § 159	28
Okla. Stat. Ann. tit. 15, § 165	28
Okla. Stat. Ann. tit. 15, § 170	28
ADMINISTRATIVE REGULATIONS	
18 C.F.R. § 154.93 * (1992)	2, 3, 6, 14
18 C.F.R. § 270.205(a)* (1992)	2
OTHER	
H.R. Conf. Rep. No. 1126, 95th Cong., 2d Sess. (1978), *reprinted in* 1978 U.S.C.C.A.N. 8800	7, 8
Moore's Federal Practice (1995)	24
Oklahoma Uniform Jury Instructions, Civil (Okla. Sup. Ct. Comm. for Uniform Civil Jury Instr. 2d Ed.)	26
Stephen A. Saltzburg, *et al.*, 1 Federal Rules of Evidence Manual (6th ed. 1994)	25

---

* This regulation was removed from FERC's regulations. *Removal of Outdated Regulations Pertaining to the Sales of Natural Gas Production*, Order No. 567, III F.E.R.C. Stats. & Regs. (CCH) ¶ 30,999 (1994).

TABLE OF AUTHORITIES—Continued

Page

Jacob A. Stein, *et al.*, Administrative Law, § 51.01[2] (1995) 16

Jack B. Weinstein, *et al.*, 1 Weinstein's Evidence § 300[02], 301[05] (1995) 14, 24

PETITION FOR WRIT OF CERTIORARI

Petitioners, Robert W. Scarth, *et al.* ("Scarth"), respectfully petition for a writ of *certiorari* to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS AND ORDERS BELOW

The Fifth Circuit's opinion is reported at 50 F.3d 1341 (5th Cir. 1995). App. 1a-14a. Scarth's Petitions for Rehearing and Rehearing *En Banc* of that Opinion were denied on July 5, 1995, and is unreported. App. 100a. The Fifth Circuit reversed orders issued in *NICOR Exploration Co.* by the Commission, reported at 63 FERC ¶ 61,034 (1993) and 66 FERC ¶ 61,276 (1994), App. 54a-75a and 76a-99a, respectively. The foregoing orders are rehearing orders related to an Initial Decision issued by an Administrative Law Judge ("ALJ"), 56 FERC ¶ 63,023 (1991), and an initial FERC order affirming the Initial Decision, 58 FERC ¶ 61,203 (1992), App. 15a-31a and 32a-53a, respectively.

JURISDICTION

The judgment of the United States Court of Appeals for the Fifth Circuit was entered on April 27, 1995. Scarth's timely Petition for Rehearing and Petition for Rehearing *En Banc* were denied on July 5, 1995. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1), § 19(b) of the Natural Gas Act ("NGA"), 15 U.S.C. § 717r(b), and § 506(a)(4) of the Natural Gas Policy Act ("NGPA"), 15 U.S.C. § 3416(a)(4).

STATUTES AND REGULATIONS

This case involves the following statutes and regulations which are set out *verbatim* in the Appendix: Natural Gas Act, §§ 4(a), (c) and (e), 5(a), 19(b), 15 U.S.C. §§ 717c(a), (c) and (e), 717d(a) and 717r(b); Natural Gas Policy Act, §§ 2(11)-(14), 101(b)(5) and (9), 104, 108, 506(a)(4) and 601(b)(1)(A), 15

U.S.C. §§ 3301(11)-(14), 3311(b)(5) and (9), 3314, 3318, 3416(a)(4) and 3431(b)(1)(A); Okla. Stat. Ann., tit. 12, §§ 577.1, 577.2, 2301-2303 (West 1993); Okla. Stat. Ann., tit. 15 §§ 151-177 (West 1993), and FERC Regulations at 18 C.F.R. §§ 154.93 (b-1), 154.93(c) and 270.205(a)(2)(1992).[1]

STATEMENT OF THE CASE

The case arises as a result of FERC's implementation of the NGA and NGPA. The jurisdiction of the Fifth Circuit was invoked by the judicial review provisions of the NGA, 15 U.S.C. § 717r(b), and the NGPA, 15 U.S.C. § 3416(a)(4).

Under the NGA, FERC in the 1960's and 1970's determined the ceiling price that natural gas producers, such as Scarth, could charge buyers, such as NICOR, by first establishing such prices by geographical area, and then establishing such prices on a nationwide basis. *See Public Serv. Comm'n of N.Y. v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 330 (1983). The Commission in 1974 "shift[ed] from a pure historical-cost-based [approach to producer rates] to an incentive-price-based approach." *Id.* Throughout the 1970's NICOR paid the Commission-established incentive prices that were set under the NGA (Exh. 43 at 2). Congress in 1978 passed the NGPA which generally supplanted FERC's NGA ratemaking authority with a series of congressionally-established "maximum lawful prices." Congress delegated to FERC the authority to implement the NGPA, including the duty to establish rules for determining whether "area rate clauses" ("ARCs"), that had been included in producer contracts pursuant to Commission regulations under the NGA, provided contractual authority to collect the new NGPA prices.

---

[1] §§ 154.93 and 270.205 were removed in 1994 from FERC's regulations. *Removal of Outdated Regulations Pertaining to the Sales of Natural Gas Production*, Order No. 567, III F.E.R.C. Stats. & Regs. (CCH) ¶ 30,999 (1994).

Scarth's predecessor producers in 1970 entered into three gas sales contracts with NICOR's predecessor as purchaser (the Sun, GHK and Amerada contracts). Such contracts included ARCs. The ARCs generally provided that the price of gas sold under the contracts may increase if the Commission "or any successor governmental authority" prescribes a higher rate for the area in which the gas is located. App. 124a, 125a and 126a. The ARCs were included in the contracts in order to comply with a Commission regulation that prohibited all indefinite price escalator clauses except for ARCs. 18 C.F.R. §§ 154.93 (b-1) and (c) (1992). The ARCs did not contain any language limiting the price to "cost based" prices.

In response to Congress' enactment of the NGPA, FERC modified its ARC regulations by issuing *Final Regulations Amending and Clarifying Regulations Under the Natural Gas Policy Act and the Natural Gas Act*, Order No. 23, 1977-1981 F.E.R.C. Stats. & Regs., Regs. Preambles (CCH) ¶ 30,040 (1979), [hereinafter Order 23] *aff'd, Pennzoil Co. v. FERC*, 645 F.2d 360, 367 5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982) [hereinafter *Pennzoil I*]. FERC noted that issues pertaining to the use of ARCs to collect NGPA prices "are directly related and are of consequence to the Commission's administrative and enforcement responsibilities" under the NGA and NGPA. Order 23 at 30,301. *Pennzoil I* affirmed FERC's determination in Order 23 to use general contract law to determine whether ARCs permit escalation to NGPA prices, but required FERC to follow any differences that appropriate state contract law may have, and placed the burden "on the parties to inform FERC if the state law that should apply is any different from the general principles that FERC utilizes." 645 F.2d at 383-84, 387.

FERC in 1980 issued Opinion 77 as a further refinement of Order 23. *Independent Oil & Gas Ass'n of W. Va.*, 10 F.E.R.C. (CCH) ¶ 61,214 (1980) [hereinafter Opinion 77]. Opinion 77 set forth the specific contract

interpretation rules FERC would employ in determining whether an ARC permits escalation to NGPA prices.

In 1990 NICOR "protested" before FERC Scarth's attempt to collect the NGPA § 108 ceiling price under the ARCs in its contracts. The protest was heard by an ALJ who found that there was no reliable and probative extrinsic evidence of contractual mutual intent. He thus applied FERC's Opinion 77 contract interpretation rules, and held that the ARCs did not contractually authorize collection of § 108 prices. App. 20a-22a. FERC first agreed with the ALJ's ultimate conclusion of lack of contractual authorization. App. 32a-53a. Upon rehearing, FERC determined that it and the ALJ misapplied Opinion 77, and that, properly applied, such rules show that Scarth met its burden of proving contractual authorization. App. 54a-75a, *reh'g denied*, App. 76a-99a.

Upon review, the Fifth Circuit reversed, holding that (1) FERC's construction of the ARCs was not entitled to deference but should be reviewed *de novo*, which action invalidated FERC's 15-year old Opinion 77 criteria; (2) FERC failed to apply Oklahoma contract law properly although FERC found that NICOR below had argued that "the Opinion 77 interpretive standards are consistent with Oklahoma law," App. 84a; and (3) Scarth failed to satisfy his burden of proof under state law and the NGA because Opinion 77 allegedly shifted the burden of proof. The court directed FERC on remand to issue an order "denying Scarth's request for a rate increase."

REASONS FOR GRANTING THE WRIT

I. *NICOR* WAS DECIDED IN CONFLICT WITH *CHEVRON* WHICH REQUIRES DEFERENCE TO FERC'S RULES IMPLEMENTING ITS ENABLING STATUTES

The Fifth Circuit ignored the requirement in *Chevron, U.S.A., Inc. v. NRDC*, 467 U.S. 837 (1984), that compels deference to FERC's rules that implement its enabling

statutes, the NGA and NGPA.[2] The NGA delegates to FERC the responsibility to examine interstate natural gas sales contracts. *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956), held that the NGA protects the public interest by Commission "supervision of the individual contracts." *Id.* at 339. The "basic power of the Commission" is "to set aside and modify any . . . contract which it determines" to be unjust or unreasonable, which involves "the power to review . . . contracts made in the first instance by natural gas companies and, if they are determined to be unlawful, to remedy them." *Id.* at 341. Whether there is contractual authority to collect a particular rate "involves matters peculiarly within the area of the Commission's special competence" which "could hardly be aided by a further examination of the record by the Court of Appeals." *United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. 103, 114 (1958).

FERC's contract supervisory role was reemphasized with the NGPA.[3] Congress resided in FERC "both the authority and responsibility to administer the [NGPA] and, in particular, to insure the integrity of the ceiling prices established in Title I." Order 23, 1977-1981 F.E.R.C. Stats. & Regs. (CCH) at 30,304. As to gas which remained regulated by FERC under the NGA after

---

[2] *Chevron* developed a two-step process to determine whether deference should be afforded agency implementation of the statutory scheme it is entrusted to administer. The reviewing court first must determine "whether Congress has directly spoken to the precise question." *Chevron*, 467 U.S. at 842. If the statute is silent or ambiguous, the court must decide whether the "agency's answer is based on a permissible construction of the statute." *Id.* at 843. It is not necessary that the agency's construction be "the only one it permissibly could have adopted . . . or even the reading the court would have reached." *Id.* at 843 n.11.

[3] The NGPA "does not constitute a federal retreat from a comprehensive gas policy" and indeed "the NGPA in some respects expanded federal control" beyond the NGA. *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Bd. of Miss.*, 474 U.S. 409, 421 (1986).

the NGPA (such as that involved here), the *"Mobile-Sierra* doctrine requires the Commission to determine whether contractual authorization exists for the collection of the maximum lawful prices established by the [NGPA]." *Id.* at 30,305. FERC likewise noted its "responsibility . . . to determine whether contractual authority exists for collection of NGPA rates" because "rate filings inconsistent with contractual obligations are invalid." 10 F.E.R.C. (CCH) at 61,408 n.2. Moreover, "[t]he need for interpreting" ARCs "arises . . . under Section 101(b)(9) of the NGPA." *Id.* at 61,407 n.4.

FERC's delegated statutory duty under the NGPA therefore includes (1) "[j]urisdiction to interpret interstate gas sales contracts" and apply its regulations "to those contracts;" (2) the "duty to ensure compliance with [NGPA] price ceilings for regulated gas;" and (3) the "responsibility to effectively enforce compliance with the NGPA price ceilings." *Fritz v. FERC,* 876 F.2d 1224, 1228 (5th Cir. 1989).

FERC's congressionally-established supervisory role specifically includes review of gas price escalation clauses. This Court affirmed the Commission's 1962 regulation that barred all indefinite price escalator provisions, other than ARCs, noting that FERC need not "acquiesce in the use of contracts which carry provisions incompatible with a scheme of effective rate regulation." *FPC v. Texaco, Inc.,* 377 U.S. 33, 42 n.12 (1964), *quoting* Order 242, 27 F.P.C. 339, 340 (1962). ARCs permit "a change in price to the applicable just and reasonable area ceiling rate which has been, or which may be, prescribed by the Commission." 18 C.F.R. § 154.93(b-1). When the Commission replaced its area ratemaking with nationwide rates in 1974, it permitted ARCs to escalate prices to the *national* rates, despite language limiting escalations to *area* rates. *Pennzoil I,* 645 F.2d at 367, 382-83.

Following the NGPA, FERC sought to determine congressional intent respecting ARCs, but found that the NGPA's legislative history "reveals little in the way of

direct and specific guidance on this matter," and, "[i]n large measure, therefore, *the Commission is left to deduce the intent of Congress*" respecting the effect of ARCs. Order 23, 1977-1981 F.E.R.C. Stats. & Regs. (CCH), at 30,309-10 (emphasis supplied).[4] FERC issued Order 23 and Opinion 77 which established rules designed to determine whether ARCs authorize collection of any or all NGPA ceiling rates. FERC has consistently applied these longstanding rules of construction in interpreting ARCs for more than fifteen years.[5]

1. *NICOR* directly contravenes *Chevron*. *Chevron* holds that "if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute." 467 U.S. at 843. While Congress did not direct FERC how to supervise ARCs, FERC being "left to deduce the intent of Congress," *FERC was delegated the authority to address this supervisory issue*, and *Chevron* held that "[i]f Congress has explicitly left a gap for an agency to fill, there is an express delegation of authority to the agency." 467 U.S. at 843-44. In 1980 FERC in Opinion 77 adopted ARC interpretation rules to supervise gas sales contracts subject to its jurisdiction, and applied its rules in this adjudication. In such a case "a court may not substitute its own construction . . . for a reasonable [agency] interpretation." *Chevron*, 467 U.S. at 844. *Pauley v. Bethenergy Mines, Inc.*, 501 U.S. 680, 698 (1991), held:

---

[4] Although the NGPA does cede Commerce Clause authority to the states to supervise indefinite price escalator clauses in *intrastate* contracts, FERC retained its full supervisory authority under such statute relative to such clauses, including ARCs, in *interstate* contracts. H.R. Conf. Rep. No. 1752, 95th Cong., 2d Sess. 125 (1978), *reprinted in* 1978 U.S.C.C.A.N. 8800, 9041 [hereinafter Conference Report].

[5] *See, e.g., Colorado Interstate Gas Co.*, 44 F.E.R.C. (CCH) ¶ 61,023 (1988); *Oklahoma Natural Gas Gathering Co.*, 23 F.E.R.C. (CCH) ¶ 61,308 (1983); *Equitable Gas Co.*, 23 F.E.R.C. (CCH) ¶ 61,015 (1983).

> When Congress, through express delegation or the introduction of an interpretive gap in the statutory structure, has delegated policymaking authority to an administrative agency, the extent of judicial review of the agency's policy determinations is limited.

Congress clearly delegated policymaking authority to FERC under the NGPA by permitting FERC "to issue rules and orders under the Act, and to perform any and all acts as it may find necessary or appropriate to carry out the provisions of this Act." Conference Report at 116, *reprinted in* 1978 U.S.C.C.A.N. at 9032-33, discussing NGPA § 501, 15 U.S.C. § 3411. *See also* NGPA § 16, 15 U.S.C. § 717*o*.

2. FERC exercised its delegated authority and "special competence" under the NGA and NGPA in interpreting Scarth's 1970 ARCs that had been developed to comply with FERC's regulation that limited the permissible language. FERC's interpretation of the scope of its statutory authority, implemented through Opinion 77, and this adjudication:

> represents a reasonable accommodation of manifestly competing interests and is entitled to deference: the regulatory scheme is technical and complex,[1] the agency considered the matter in a detailed and reasoned fashion,[1] and the decision involves reconciling conflicting policies.

Chevron, 467 U.S. at 865 (citations omitted). Opinion 77 noted that ARCs "were a product of the then prevailing [NGA] regulatory scheme". 10 F.E.R.C. (CCH) at 61,396. Opinion 77 reconciled the policy question of whether ARCs would also permit collection of NGPA prices. 10 F.E.R.C. (CCH) at 61,396-97. FERC applied both its expert knowledge of this technical area and the "prevailing regulatory scheme" to the Scarth ARCs to determine that NICOR agreed to pay the highest rate permitted by law. App. 61a, n.14; 91a-92a, n.25. FERC thereby exercised its statutory authority and duty of determining the appropriate NGPA price category eligi-

bility.[6] FERC's implementation of the NGA and NGPA through Opinion 77 and this adjudication was reasonable, and the Fifth Circuit erred by failing to apply *Chevron* and accord deference to FERC.

II. THIS COURT SHOULD RESOLVE THE CLEAR CONFLICT AMONG CIRCUITS CONCERNING DEFERENCE TO AGENCY INTERPRETATIONS OF CONTRACTUAL LANGUAGE SUBJECT TO AND DEVELOPED TO COMPLY WITH AGENCY REGULATIONS

Certiorari should also be granted to resolve the square and irreconcilable conflict betwen the Fifth Circuit's *NICOR* decision and the D.C., Fourth, Seventh and Tenth Circuits on the issue of judicial deference under *Chevron* to an agency's interpretation of contracts subject to and developed to comply with agency regulations.

A. *NICOR* Directly Conflicts With Other Circuits

NICOR held that FERC's contract construction is not entitled to deference but should be reviewed *de novo* because FERC allegedly did not exercise its expertise. App. 10a. *NICOR* is incorrect. As shown in Section I, *supra*, FERC did exercise its regulatory expertise in interpreting the ARCs in Scarth's contracts, and therefore its interpretation is entitled to deference. In contrast, just recently in *Northwest Pipeline Corp. v. FERC*, 61 F.3d 1479, 1486 (10th Cir. 1995), the Tenth Circuit applied *Chevron* and deferred to FERC's interpretation of language contained in natural gas tariffs. Such tariffs "are binding contracts," and "[t]he task of interpretation of tariffs . . . is akin to the task of statutory interpreta-

---

[6] *Pennzoil Co. v. FERC*, 671 F.2d 119 (5th Cir. Unit A 1982), held that "[a]dvertence to the terms of private contracts in delineation of eligibility for price categories is not novel," and noted that FERC often made reference to contract terms in determining price eligibility under the NGA. *Id.* at 126-27. *See, e.g., Superior Oil Co. v. FERC*, 569 F.2d 971, 974-75 (5th Cir.), *cert. denied*, 439 U.S. 834 (1978).

tion . . . [both involving] mainly questions of law." *Coca-Cola Co. v. Atchinson, T. & S.F. Ry.*, 608 F.2d 213, 219 (5th Cir. 1979). Scarth's contracts with NICOR are its FERC tariffs. Tariff provisions are developed to comply with FERC regulation, just as Scarth's ARCs were developed to comply with Commission regulation.

The Tenth Circuit stated that a reviewing court "is not free to substitute its own judgment for that of the agency, but must instead uphold the agency decision if there is a rational basis for that decision." *Northwest*, 61 F.3d at 1486. The Tenth Circuit relied on FERC's experience in interpreting contract language in a tariff, *id.*, and stated that while FERC's interpretation was "not the only possible construction," it was reasonable and "entitled to . . . deference." *Id.* at 1487 (citation omitted).

The Tenth Circuit also relied upon the D.C. Circuit's similar holdings in *Williams Natural Gas Co. v. FERC*, 3 F.3d 1544 (D.C. Cir. 1993), and *National Fuel Gas Supply Corp. v. FERC*, 811 F.2d 1563 (D.C. Cir.), *cert. denied*, 484 U.S. 869 (1987). *Williams* held that "FERC's interpretation" of contracts "is properly reviewed under the principles enunciated in *Chevron*," which requires a determination of whether the contract is ambiguous, but held that deference to FERC's construction of ambiguous contracts is required "so long as it is reasonable." 3 F.3d at 1551.[7]

In *National Fuel*, the D.C. Circuit held that under the principles of *Chevron*, judicial deference to *FERC's* in-

[7] *Williams* involved interpretation of a contract to determine compliance with FERC's regulations. *Williams* relied upon *Natural Gas Clearinghouse v. FERC*, 965 F.2d 1066, 1070 (D.C. Cir. 1992) ("Congress explicitly delegated to FERC broad powers . . . including the power to analyze relevant contracts", *quoting Tarpon Transmission Co. v. FERC*, 860 F.2d 439, 441-42 (D.C. Cir. 1988), which also held that "[a]lthough the interpretation . . . is a matter of contract law, we nonetheless owe deference").

terpretation of contractual language is required. 811 F.2d at 1569. The D.C. Circuit acknowledged that "the federal appellate courts have taken different positions," and that the Fifth Circuit was in conflict with it on the applicability of *Chevron*, but held that its own position was the "better view." 811 F.2d at 1568, 1570.

In *National Fuel* the D.C. Circuit further held that the delegation to an agency to administer a congressionally created program supports affording deference to agency contractual interpretations, noting that Congress "specifically delegated to the Commission a broad range of adjudicative powers over natural gas rates" and this "explicit delegation of power . . . compels a court to give deference to the agency's conclusions even on 'pure' questions of law within that domain." 811 F.2d at 1569-70, citing *Chevron*, 467 U.S. at 843-44. Consistent with statutory delegation was the further finding that the agency's interpretation:

> [T]ypically *will* be enhanced by technical knowledge. Construction of a [contract] will be influenced by the agency's expertise in the technical language of that field and by its greater knowledge of industry conditions and practices, including its more comprehensive experience with the kinds of disputes and negotiations that generally produce such an agreement.

811 F.2d at 1570. Finally, the D.C. Circuit found that *Chevron* "implicitly modified earlier cases that adhered to the traditional rule of withholding deference on questions of contract interpretation." *Id.*

The Fourth Circuit also conflicts with *NICOR*. *Consolidated Gas Supply Corp. v. FERC*, 745 F.2d 281, 291 (4th Cir. 1984), *cert. denied*, 472 U.S. 1008 (1985), held that FERC's interpretation of a settlement contract is entitled to deference, and that a court should not disregard the agency's expertise.

Similarly, the Seventh Circuit holds that with respect to contract interpretation issues, "[w]e owe some defer-

ence to . . . [FERC] as an expert body dealing regularly with natural gas supply contracts." *Amoco Prod. Co. v. FERC*, 765 F.2d 686, 690 (7th Cir. 1985). *See also Pacific Gas & Elec. Co. v. FERC*, 746 F.2d 1383, 1387 (9th Cir. 1984) (deference provided to FERC contract interpretation of *unambiguous* contract because "FERC employed its unique expertise in rate-setting contracts and . . . expertise in electricity transmission regulation").[8]

B. *Certiorari* Is Appropriate To Resolve The Foregoing Conflict Among Circuits

1. *Certiorari* has been granted to resolve important conflicts.[9] Granting *certiorari* to resolve the conflict among the circuits in the application of *Chevron* will provide consistency respecting the appropriate deference to be afforded agency interpretations of contracts that are subject to and were developed to comply with agency regulation.

2. The circuit conflict respecting agency contract deference is likely to recur. Such conflict was previously observed in *National Fuel*. 811 F.2d at 1570. The recent *NICOR*, *Northwest* and *Williams* decisions demonstrate the continuing nature of the conflict.

3. *Chevron* deference is appropriate here because the Fifth Circuit acknowledged that the ARCs are ambigu-

---

[8] Indeed, some circuits have extended *Chevron* far beyond agency contract interpretations, to include *all* agency legal determinations. For example, the Second Circuit reviews agency *legal conclusions* only for arbitrariness, capriciousness, and abuse of discretion. *First Indep. Group, Inc. v. SEC*, 37 F.3d 30, 32 (2d Cir. 1994), *citing Higgins v. SEC*, 866 F.2d 47, 49 (2d Cir. 1989). The Seventh Circuit upholds agency determinations where its "factual findings are supported by substantial evidence and its legal conclusions have a reasonable basis in the law." *Electromation, Inc. v. NLRB*, 35 F.3d 1148, 1155 (7th Cir. 1994), citing *NLRB v. Augusta Bakery Corp.*, 957 F.2d 1467, 1471 (7th Cir. 1992).

[9] *Chemical Mfrs. Ass'n v. NRDC*, 470 U.S. 116, 125 (1985); *Lehman v. Lycoming County Children's Serv. Agency*, 458 U.S. 502, 507 (1982); *Aldinger v. Howard*, 427 U.S. 1, 3 (1976).

ous, App. 4a, and FERC's contract interpretation was in furtherance of its statutory duties and has a reasonable result. Unlike the Fifth Circuit's decision in *NICOR*, had the principles of *Chevron* been applied by the D.C., Fourth, Seventh and Tenth Circuits, those courts would not have reviewed the matter *de novo*, but would have accorded deference to FERC's reasonable interpretation of the ARCs.

III. *NICOR* CONFLICTS WITH THIS COURT'S DECISIONS THAT REQUIRE AFFIRMANCE OF AGENCY FACTUAL INFERENCES THAT ARE SUPPORTED BY SUBSTANTIAL EVIDENCE

Certiorari is appropriate because the court below "misapprehended or grossly misapplied the substantial-evidence standard." *Mobil Oil Corp. v. FPC*, 417 U.S. 283, 292 (1974). The NGA and NGPA have identical judicial review limitations providing that "[t]he finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive." 15 U.S.C. 717r (b)(NGA); 15 U.S.C. § 3416(a)(4)(NGPA). The Fifth Circuit ignored these statutory limitations and incorrectly reviewed the facts *de novo* without regard to FERC's conclusive findings.

A. There Was No Requisite Finding That FERC's Opinion 77 Factual Inferences Were Not Based On Substantial Evidence

NICOR held that FERC, in applying Opinion 77 to the Scarth contracts, unlawfully shifted the burden of proof from Scarth to NICOR, and "created a presumption in favor of Scarth." App. 13a. The court did not determine whether the alleged "presumption" was one of fact (actually an inference) or one of law. Properly viewed, Opinion 77 established certain factual inferences (often mistakenly referenced as presumptions of fact) rather than a legal presumption.[10] Factual inferences do

[10] An inference is not truly a presumption, but instead the existence of the inferred fact may be deduced from the base facts

not shift the burden of proof. Thus, the court erred in invalidating the factual inferences established in Opinion 77. Indeed, it made *no finding* that such inferences were not based on substantial evidence, and therefore FERC's Opinion 77 inferences, which are based on substantial evidence, are conclusive.

FERC in Opinion 77 noted that it previously dealt extensively in its Order 23 series with the issue of whether ARCs authorize NGPA rates, and that the Order 23 record indicated substantial industry agreement that ARCs generally permitted *all* NGPA rates.[11] 10 F.E.R.C. (CCH) at 61,396. Refining Order 23, Opinion 77 established inferences applicable "where other extrinsic factors are unavailable or unreliable," such as where there is no reliable and probative evidence of mutual intent relating specifically to the contract, or such evidence is inconclusive. *Id.* at 61,401, 61,398. FERC established the Opinion 77 inferences based upon the "extrinsic factors" of (1) the "record developed in the [Order 23] rulemaking proceedings;" (2) the "accumulated experience of the Commission in dealing with . . . [ARC's] in a variety of settings," and (3) FERC's recognition that ARCs "were a product of the then prevailing [NGA] regulatory scheme," which included the regulatory and commercial context that the permissible language of ARCs was limited by a FERC regulation at the risk of rejection for non-compliance. *Id.* at 61,396, 18 C.F.R. §§ 154.93(b-1), (c).

Under the Opinion 77 inferences FERC will *generally conclude*:

> that a contract containing an [ARC] did not authorize collection of incentive NGPA rates if: (1)

"by the ordinary rules of reasoning and logic," while in the case of a presumption the existence of the presumed fact must initially be assumed "because of a rule of law." 1 Jack B. Weinstein, *et al.*, Weinstein's Evidence ¶ 300[01], at 300-2 (1995).

[11] The Fifth Circuit acknowledged that Order 23 was promulgated "after extensive feedback and comment from gas producers, pipelines and local distributors." App. 3a-4a, n.2.

> the text of the [ARC] refers to rates established by an administrative body, (2) the reference to administrative action is coupled with a reference to the [NGA] or [its] "just and reasonable" standard . . ., and (3) the contract contains no additional language having the effect of "uncoupling" the link between agency action and the just and reasonable standard.[1] If either of the first two provisions is not present in the text of the [ARC], or if the contract contains uncoupling language, then the [ARC] must be held to authorize all NGPA ceiling rates.

App. 69a. Thus, if the "basic facts" set forth in (1), (2) and (3) of the quote are shown, FERC will infer the ultimate fact of a mutual intent, not to collect incentive NGPA rates, but instead to collect cost-based NGPA rates only. Conversely, the ultimate fact of a mutual intention to collect all NGPA rates will be inferred if the basic facts are shown that either: (1) there is no reference to agency rate establishment; or (2) there is such a reference, but it is not coupled to the NGA or its just and reasonable ("J&R") standard; or (3) there is a coupling of the reference to agency ratemaking to the NGA, or its J&R standard, but there is additional language uncoupling the link.

Justice Scalia has explained the relationship of factual inferences to the substantial evidence test:

> [an inference] is "[a] process of reasoning by which a fact or proposition sought to be established is deduced as a logical consequence from other facts, or a state of facts, already proved or admitted" . . . . [i]nferences (or presumptions of fact)—are not creatures of the [agency] but its masters, representing the dictates of reason and logic that must be applied in making adjudicatory factual determinations. Whenever an agency's action is reversed in court for lack of "substantial evidence," the reason is that the agency has ignored inferences that reasonably must be drawn, or has drawn inferences that reasonably cannot be.

NLRB v. Curtin Matheson Scientific, Inc., 494 U.S. 775, 814-15 (1990) (Scalia, J., dissenting). The Fifth Circuit never made the requisite finding that FERC's Opinion 77 factual inferences "reasonably cannot be," but instead unlawfully substituted its own factual inferences for those of FERC.

The "weight to be given to the facts . . . as well as the inferences reasonably to be drawn from them" is for the agency. *FTC v. Pacific States Paper Trade Ass'n*, 273 U.S. 52, 63 (1927). The agency's function is "to draw such reasonable conclusions from its findings as in its discretion are appropriate," and "[i]t is not for the court to strike down conclusions that are reasonably drawn from the evidence and findings." *Illinois Cent. R. v. Norfolk & W. Ry.*, 385 U.S. 57, 69 (1966). The substantial evidence rule "is analogous to appellate review of judgments predicated on jury verdicts." 5 Jacob A. Stein, *et al.*, Administrative Law, § 51.01[2], at 51-51 (1995). The Fifth Circuit elsewhere has acknowledged:

> A jury may draw reasonable inferences from the evidence, and those inferences may constitute sufficient proof to support a verdict. . . . On appeal, we are bound to view the evidence and all reasonable inferences in the light most favorable to the jury's determination. . . . Even though we might have reached a different conclusion if we had been the trier of fact, we are "not free to reweigh the evidence. . . ." We must not substitute for the jury's reasonable factual inferences other inferences that we may regard as more reasonable.

Rideau v. Parkem Indus. Serv., 917 F.2d 892, 897 (5th Cir. 1990) (citations omitted). And if the evidence "is such that it supports inconsistent inferences and conclusions, the courts must defer to [the agency's] choice." *Nueces County Navig. Dist. No. 1 v. ICC*, 674 F.2d 1055, 1063 (5th Cir.), *cert. denied*, 459 U.S. 1035 (1982). The Fifth Circuit ignored these principles with respect to FERC's Opinion 77 inferences, by *failing to determine* that they were not based on substantial evi-

dence, but nevertheless imposing "a different conclusion . . . [than] the trier of fact." *Rideau*, 917 F.2d at 897.[12]

1. The Fifth Circuit contravened the substantial evidence test respecting FERC's factual inferences relative to the ARC in the Amerada contract. FERC found the ultimate fact that the mutual intent under that contract was to allow all NGPA rates, based upon its finding of basic facts that there was a reference in the Amerada ARC to administrative action, but *no reference* to the NGA or its J&R standard. App. 70a. FERC rejected NICOR's request to infer such a reference because "none existed in the text of the clause." App. 94a. Consequently, FERC found that "it was reasonable to conclude" that such contract "does not preclude the collection of any particular ceiling rate," including the congressional NGPA incentive rates. App. 95a.

FERC relied upon Opinion 77, which justified this factual inference:

> Where a reference to administrative action is not coupled with a reference to the [NGA or its] statutory standard . . . [FERC] will generally find that all of the NGPA rates are authorized. . . . A contractual provision with no reference to a particular ratemaking standard would generally indicate an intent to permit prices to rise to the highest prices permitted by law. . . . [FERC's] ratemaking power under the [NGA] was delegated to it by the Con-

[12] Apart from the Opinion 77 inferences, *NICOR* also ignored and failed to give conclusive weight to, FERC's *factual finding* that NICOR's position below was that "the Opinion No. 77 interpretive standards are consistent with Oklahoma state law." App. 84a. *Pennzoil I* held that the burden is upon a party "to inform FERC if the state law that should apply is any different from [FERC's] general [contract] principles." 645 F.2d at 387. Similarly, under Oklahoma law a claim that another state's law applies is a "question of fact" that must be timely pleaded so as to permit submission of contrary evidence, and if not timely pled foreign law "is presumed to be the same as the law of the forum," which was FERC. *C.I.T. Corp. v. Edwards*, 418 P.2d 685, 688-89 (Okla. 1966).

> gress. We will not assume, in the absence of specific language or reliable and probative evidence, that the parties intended to be bound by an agency determination but not by a mandate emanating from the source of that agency's authority. Hence, we decline to conclude that the mere transfer of the ratemaking function from the Commission to the Congress—most likely unforeseen by the parties . . . should operate to defeat [their] intent . . . simply because they expressed that intent in terminology which was based on the regulatory scheme then in force.

10 F.E.R.C. (CCH) at 61,398-99. FERC made the further *factual finding* that its Opinion 77 inference is supported by the evidentiary record because NICOR did not object to congressionally-established rates, but instead its evidence was only offered to prove that it allegedly intended to pay only cost-based rates, and it was only in its rehearing brief, after losing, that NICOR "approached the issue of what type of ratemaking forum was contemplated (Congress or an . . . agency)." App. 99a. This factual finding is "conclusive" and the Fifth Circuit violated the substantial evidence test by ignoring it.

The Fifth Circuit provided *absolutely no discussion of the Opinion 77 inferences as applied to the Amerada contract,* and thus made no finding that such inferences were not based on substantial evidence. It also acknowledged FERC's *factual finding* that such contract "failed to refer to the NGA or to the 'just and reasonable' standard." App. 6a. FERC's factual findings, including the ultimate finding of mutual intent to authorize all NGPA rates under such contract, is "conclusive."

2. The Fifth Circuit also contravened the substantial evidence test respecting the Sun and GHK contracts, because it also made no finding that FERC's Opinion 77 inferences respecting the ARCs in such contracts were not based on substantial evidence. The Sun and GHK

ARCs did refer to the basic facts of agency-established rates and the J&R standard (but not the NGA). FERC nevertheless made the *factual finding* that the linking of agency action to the J&R standard was uncoupled because such contracts' "inclusion of rates set by 'any successor governmental authority' permits the collection of rates set by Congress," and not just by agency action. App. 72a. FERC noted the foundation of this factual inference:

> . . . the Commission held in Opinion No. 77 that, "if a reference to administrative action is followed by language broad enough to encompass legislative enactments, the clause would appear to indicate that the parties did not intend to be restricted to the outcome of an agency proceeding." . . . In this case there is nothing . . . that can clearly be read as excluding rates set by Congress or in any way limiting the scope of authority exclusively to rates set by an [agency].

App. 73a-74a.[13]

FERC's factual conclusion respecting the ARCs in these contracts is further supported by the contracts' "Regulation" clause, which anticipated possible future statutory changes by providing that they are "subject to all present and future valid laws and lawful orders and regulations of all regulatory bodies now or hereafter having jurisdiction." App. 124a-126a. This Court has held that such provisions "stem from the assumption that the contracts are subject to governmental price and other regulation . . . . Their purpose is to 'provide that the contract shall continue in effect though modified to conform to the requirements of such law or regulation.'" *Energy Reserves Group, Inc. v. Kansas Power & Light*

---

[13] In Opinion 77 FERC also found that a reference to a "successor statutory authority" or similar words reflect that "the parties commit their contractual destiny to a change in the statutory scheme and give advance acceptance to the outcome of the legislative process." 10 F.E.R.C. (CCH) at 61,399.

Co., 459 U.S. 400, 416 n.22 (1983) (*quoting* 4 H. Williams, *Oil & Gas Law* § 734, at 800-802 (1981)). Moreover, FERC here found that the evidence supported its inference because it made the *factual finding* that NICOR did not present evidence objecting to congressionally-prescribed rates, but instead its evidence addressed *only* its claim that cost-based rates were intended. App. 74a, n.33; 99a.[14]

In sum, by failing to make findings that FERC's inferences of fact were not supported by substantial evidence, and instead substituting its own factual findings, the Fifth Circuit violated this Court's decisions relative to factual inferences and substantial evidence.[15]

B. The Court Also Relied Upon Invalid Factual Findings Contrary To The Substantial Evidence Test

The Fifth Circuit summarizes its holding in its final paragraph, declaring that "[b]ased on the findings in the

---

[14] FERC also found that the reference in the GHK and Sun contracts to the J&R standard of the NGA did not restrict the "successor governmental authority" language to only administrative actions. App. 96a. FERC interpreted the plain language of the NGPA finding that Congress expressly deemed *all* NGPA prices to be "just and reasonable" for purposes of the NGA. App. 74a. *See* 15 U.S.C. § 3431(b)(1)(A) (this section was replaced in 1989 with a new 15 U.S.C. § 3431(b)(1)(A)). *Pennzoil I* held that "just and reasonable" is "merely a term of art for the public interest," and further noted that "[c]ongressionally established rates are of course prescribed in the public interest, and therefore are within the meaning of 'just and reasonable.'" 645 F.2d at 379 n.37, 383 n.45.

[15] The Fifth Circuit also ignored other FERC factual findings that: (a) "the producers intended to get the highest lawful rate;" (App. 91a, n.23; 58a); (b) NICOR's witnesses conceded "there is no evidence that . . . a 'cost-based' limitation" was ever expressed in negotiations (App. 60a, 79a); (c) NICOR did not object to rates set *by Congress* (App. 99a); and (d) when the contracts were negotiated (1969-1970) there was "no specific FPC-established ceiling rates" for gas under the contracts and in such contracts NICOR *agreed to pay* "a non-cost-based" rate. App. 61a, n.14; 91a-92a, n.25.

ALJ's order and the Commission's original order affirming the ALJ, Scarth failed to prove by a preponderance of the evidence that the contracting parties intended to authorize [NGPA] § 108 prices." App. 14a. Thus, for its ultimate conclusion, the court relied upon the findings of the ALJ in his Initial Decision and FERC in its first order. But FERC modified these findings in its second and third orders. It is these latter orders which are the operative FERC orders under review. A court reviews the interpretation of the agency, and not the ALJ, even if it prefers the ALJ's approach. *Bullion v. FDIC*, 881 F.2d 1368, 1374 (5th Cir. 1989).[16]

This Court's cases "forbid[] a court to 'make its own appraisal of the testimony, picking and choosing for itself among uncertain and conflicting inferences.'" *FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447, 454 (1986). The Fifth Circuit improperly picked and then chose to endorse the ALJ and first FERC order findings which FERC itself modified, rather than the effective second and third FERC order findings. The Fifth Circuit thereby (a) "disregarded well-established standards for reviewing the factual findings of agencies;" (b) endorsed "particular findings which the court thought appropriate, but which were contrary to those actually made" in the operative orders; and (c) violated the principle that "[t]he court should not supplant the agency's findings merely by identifying alternative findings that *could be* supported by substantial evidence." *Arkansas v. Oklahoma*, 503 U.S. 91, 112-13 (1992) (emphasis added).[17]

---

[16] At best, the ALJ's findings can be considered to determine whether FERC's findings are supported by substantial evidence. But the Fifth Circuit did not do this. Nowhere did it conclude that FERC's findings in its second and third orders were not based on substantial evidence. *See NLRB v. Brooks Cameras, Inc.*, 691 F.2d 912, 915 (9th Cir. 1982) (when the agency and ALJ make contrary findings, "the [substantial evidence] deference accorded fact findings runs in favor of the [agency]," not the ALJ).

[17] *See also Consolo v. Federal Maritime Comm'n*, 383 U.S. 607, 620 (1966); *Cia Mexicana De Gas, S.A. v. FPC*, 167 F.2d 804, 806

IV. *NICOR* WAS DECIDED IN CONFLICT WITH THIS COURT'S DECISIONS CONCERNING AN AGENCY'S USE OF PRESUMPTIONS AND THEIR SCOPE OF REVIEW

Even assuming, *arguendo*, that FERC utilized a "legal presumption" rather than a factual inference in applying Opinion·77, *certiorari* should be granted because *NICOR* (1) directly conflicts with Supreme Court cases permitting the use of regulatory presumptions; and (2) failed to apply the Supreme Court's decisions concerning the appropriate standard for reviewing legal presumptions.

The "development of . . . presumptions is normally the function" of the agency, *NLRB v. Baptist Hospital, Inc.*, 442 U.S. 773, 789 (1979), and "its conclusions on such matters are traditionally accorded considerable deference." [18] *Id.* at 796 (Brennan, J., concurring). The validity of such presumptions depend upon the rationality of what is proved and what is presumed. *Beth Israel Hospital v. NLRB*, 437 U.S. 483, 493 (1978). A challenging party "bears the heavy burden of demonstrating that there is no rational connection between the fact proved and the ultimate fact to be presumed." *Cole v. United States Dep't of Agric.*, 33 F.3d 1263, 1267 (11th Cir. 1994), *cert. denied*, 115 S. Ct. 1956 (1995).

1. *NICOR* patently erred in stating the nature of the presumption FERC employed. The court erroneously claims Opinion 77 "essentially created a presumption in favor of Scarth" by allegedly presuming that ARCs gen-

---

(5th Cir. 1948) ("[a] commission, like a court, may, indeed should, change its findings and order if on rehearing it is of a different mind. *If it does so change, our function on a review of its findings and order is to determine not which of the two findings and orders was the best but whether . . . the findings and order under review are without evidence to support them*") (emphasis added).

[18] *NICOR* also contravened Court pronouncements that a *judicial* "presumption of validity . . . attaches to each exercise of the Commission's expertise," *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968) (citation omitted).

erally permit NGPA § 108 rates unless the ARC satisfies all three prongs of Opinion 77. App. 13a, *citing* App. 86a. In Opinion 77, FERC stated its general conclusion was just the opposite. Instead of favoring § 108 rates, FERC stated in Opinion 77 that "the Commission will generally conclude that a contract containing an [ARC] *did not* authorize collection of incentive NGPA [§ 108] rates." App. 69a (emphasis added). What was "presumed" in Opinion 77 was that only cost-based NGPA rates were permitted if the ARC linked agency-established rates to the NGA (or its J&R standard), and there was no uncoupling of this link. FERC found that Scarth rebutted this presumption by showing that (1) there was no linking of agency rates to the NGA respecting the Amerada ARC, and (2) the Sun and GHK ARCs had "successor governmental authority" language uncoupling the link. Therefore, FERC found that Scarth showed that the parties intended whatever rate was authorized by the government. App. 69a-75a.

2. Assuming, *arguendo,* that Opinion 77 created a "legal presumption" in favor of incentive NGPA rates, that presumption is valid under Supreme Court precedent. FERC's Opinion 77 rules were based on its own expert knowledge of the commercial and regulatory context when contracts with ARCs were executed and any "legal presumption" was based on its view of "fairness, public policy . . . probability . . . and [administrative] economy." *Basic Inc. v. Levinson,* 485 U.S. 224, 245 (1988). *See* Opinion 77, 10 F.E.R.C. (CCH) at 61,400-02, for FERC consideration of similar factors in Opinion 77. The Fifth Circuit, in attacking the "presumption" (App. 13a-14a), made no contention, and therefore no finding, that there was not a rational connection between what FERC proved and what FERC presumed. Particularly in view of the Fifth Circuit's failure to apply the "rational connection" standard of review, substantial deference should be accorded any legal presumptions made by FERC.

3. Again assuming, *arguendo*, that Opinion 77 created a "legal presumption" in favor of incentive NGPA rates, *NICOR* erred in holding that FERC's presumption unlawfully shifted the burden of proof by requiring NICOR to prove the absence of contractual authority. App. 12a. Such *NICOR* holding unlawfully failed to give the Opinion 77 presumption the effect required by Federal Rule of Evidence 302, which provides that "the effect of a presumption respecting a fact which is an element of a claim or defense as to which State law supplies the rule of decision." App. 123a. Here, the Fifth Circuit held (App. 9a-10a) that Oklahoma contract law applies. Oklahoma law on the effect of presumptions therefore controls. Under Oklahoma law the effect of a presumption is to shift the *burden of proof* to NICOR.[19] FERC effectively found that NICOR failed to meet this state law burden. App. 86a ("NICOR did not prove by a preponderance of the evidence that the parties had a mutual intent to limit . . . [ARCs] to only cost-based rates").[20] While Scarth had the ultimate federal law burden of proving that its rate is just and reasonable, that burden was met because Scarth had contractual authority, as determined under applicable state law, to collect the NGPA, § 108 rate.

4. *NICOR* erred even if the federal, rather than state law, effect of presumptions is applied. Rule 301 of the Federal Rules of Evidence operates "as a procedural device to shift the burden of producing evidence, exposing the opponent of the presumption to the risk of an adverse result on a directed verdict if he fails to present

---

[19] *See* Okla. Stat. Ann. tit. 12, §§ 2301-2303; 1 Weinstein's Evidence ¶ 301[05], at 301-97 to -98; *Brown v. Oklahoma Transp. Co.*, 588 P.2d 595, 600 (Okla. Ct. App. 1978); *Nanonka v. Nanonka*, 645 P.2d 507, 508 (Okla. 1982). The burden of proof is a matter of substantive law under *Erie*. 10 Moore's Federal Practice § 302.02, at III-36 (2d ed. 1995).

[20] FERC's findings in Opinion 77 that the base facts of its construction rules are probative of the presumed fact of mutual intent also satisfy the requirements of Oklahoma law for valid legal presumptions. App. 69a-75a; 10 F.E.R.C. (CCH) at 61,398-99.

enough evidence to support a finding of the nonexistence of the presumed fact." 1 Stephen A. Saltzburg, *et al.*, Federal Rules of Evidence Manual 140 (6th Ed. 1994). Here, FERC made the factual finding that "the evidence was inconclusive on whether NICOR made a case for its alleged intent to have a cost-based limitation" on the ARCs. App. 79a. Thus, NICOR failed in its federal law burden of producing evidence to rebut any Opinion 77 "legal presumption" because it failed "to present enough evidence to support the nonexistence of the presumed fact." [21]

V. THIS COURT SHOULD EXERCISE ITS SUPERVISORY POWERS BECAUSE *NICOR* FAILS TO APPLY OKLAHOMA LAW AND IS CLEARLY CONTRARY TO DECISIONS OF OKLAHOMA'S COURTS

While *NICOR* states that the law of Oklahoma is to apply (App. 10a), it fails to apply Oklahoma law. Thus, *NICOR* did not simply misapply "a properly stated rule of law," Sup. Ct. R. 10, and this Court should exercise its supervisory powers. This Court has set aside appellate rulings as to state law where, as here, the lower court's ruling on state law constitutes " 'plain error' . . . the lower court is 'clearly wrong' . . . or the construction is 'clearly erroneous' . . . or 'unreasonable' ". *Brockett v. Spokane Arcades, Inc.*, 472 U.S. 491, 500 n.9 (1985). *Certiorari* is particularly appropriate because the Fifth Circuit was not ruling on the law of a state within its circuit, where it might have expertise, which is a primary basis for this Court's deference in other cases to appellate court's interpretations of state law. *Id.* at 500.

1. *NICOR* committed plain error in claiming that Scarth did not meet his Oklahoma law burden of proof because he failed "to prove by a preponderance of the

---

[21] Even if NICOR had presented sufficient evidence so that the mandatory presumption drops from the case, Scarth's "evidence [as plaintiff] and inferences properly drawn therefrom may be considered by the trier of fact" and may be sufficient "to discredit" NICOR's evidence (as defendant). *Texas Dep't of Comm. Affairs v. Burdine*, 450 U.S. 248, 255 n.10 (1981).

extrinsic evidence that the parties mutually intended to allow non-cost-based rates." App. 13a. Scarth's state law burden was to present a "greater weight of the evidence," *not just extrinsic evidence*, that his meaning of the contract provision "is more probably true than not true." Oklahoma Uniform Jury Instructions, Civil 21 (Okla. Sup. Ct.. Comm. for Uniform Jury Instr. 2d ed.) [hereinafter OUJI] (emphasis added), App. 132a.[22] The jury, or here, FERC, as the factfinder, is "to take into account *all the evidence.*" *Id.* (emphasis added); *see also Morrow v. Morrow*, 612 P.2d 730, 732 (Okla. Ct. App. 1980). *Even with ambiguous contracts* the jury must "first examine the language of the contract" because such language "is the primary determinant of its meaning." OUJI, App. 135a, 136a. *NICOR* therefore erred in claiming Scarth's burden was to prove its case by a preponderance of *extrinsic evidence* alone. While FERC extensively considered extrinsic evidence (App. 58a-69a), FERC also properly considered *all* of the evidence, including the language of the contracts and the regulatory circumstance of use of ARCs, and found that the greater weight of *all* evidence proved that Scarth met his burden.[23]

2. *NICOR* also committed plain error in claiming that Opinion 77 "conflicts with Oklahoma contract law"

---

[22] In accordance with state legislative direction, Okla. Stat. Ann. tit. 12, §§ 577.1, 577.2, the Oklahoma Supreme Court by order has directed that trial judges generally must utilize the OUJI instructions. SCAD 93-3, Feb. 26, 1993, App. 129a-30a. The Fifth Circuit therefore was bound to (but failed to) consider such instructions in reviewing FERC's fact-findings as the equivalent of a jury. The Oklahoma Supreme Court's order and the pertinent instructions are attached in the Appendix hereto. App. 127a-37a.

[23] The court also erred in claiming that Scarth had to prove a mutual intent "to allow non-cost-based rates." App. 13a. Scarth under Oklahoma law only had to prove that the ARCs provide contractual intent to authorize price escalations to the NGPA § 108 rate. FERC's role was to "first examine the language of the contract" (OUJI, App. 135a), which provides *no* limitation to only cost-based rates, and to assess that evidence together with the extrinsic evidence. OUJI, App. 136a. Such analysis under Oklahoma law showed, as FERC found, that NICOR's claimed cost-based limitation simply does not exist.

because FERC failed "to give any weight to the extrinsic evidence of the parties' intent." App. 10a-11a. Although Oklahoma law requires FERC to *consider* extrinsic evidence of intent, it *does not* mandate that FERC *must give weight* to such evidence. "[T]he weight of the evidence is a question for the jury," or here, FERC as the factfinder. *Rain v. Balph,* 293 P.2d 359, 362 (Okla. 1956). FERC did *consider* extensively the parties' extrinsic evidence. App. 58a-69a; 85a-92a. FERC nevertheless found that such evidence was "inconclusive," and equated "inconclusive" with not "reliable and probative." App. 69a. FERC *could not* give weight to evidence that it found was not reliable and probative, and Oklahoma law does not require otherwise. It was plain error for *NICOR* to require FERC to give weight to evidence FERC had found was not reliable and probative.

Under Oklahoma law, where the extrinsic evidence is in conflict "it becomes necessary to examine the instruments themselves," as FERC did, to determine where "the weight of the evidence . . . rests." *Iron Mountain Oil Co. v. Edwards,* 100 Okla. 4, 9, 227 P. 150 (1924); *see also Beck v. Traders & General Ins. Co.,* 77 P.2d 109, 113 (Okla. 1938) (with conflicting evidence "there is no practical construction to overcome the language of the contract"). "[T]he weight of the evidence is a question" for the factfinder. *Rain,* 293 P.2d at 362, which findings are conclusive both under Oklahoma law, *Dismuke v. Cseh,* 830 P.2d 188, 190 (Okla. 1992), and under the NGA and NGPA. 15 U.S.C. §§ 717r(b), 3416(a)(4).

3. *NICOR* committed plain error by ignoring applicable Oklahoma caselaw and Oklahoma statutory rules of construction. Okla. Stat. Ann. tit. 15, §§ 151-177 (West 1993). In fact, in one of the few Oklahoma cases *NICOR* does cite, the Oklahoma court held that in ascertaining contractual intent "if otherwise doubtful," construction rules are to be applied. *Bonner v. Oklahoma Rock Corp.,* 863 P.2d 1176, 1181 n.16 (Okla. 1993). This is what FERC did. FERC found that the extrinsic

evidence was "otherwise doubtful," and, as required by Oklahoma law, turned to the contract language and rules of construction to make its final ruling.

FERC's conclusion of contract entitlement is consistent with Oklahoma's contract construction rules, which provide that, if a promise is ambiguous, "it must be interpreted in the sense in which the promisor believed, at the time of making it, that the promisee understood it," and a contract "should be interpreted most strongly against the party who caused the uncertainty to exist," and "[t]he promisor is presumed to be such party." Okla. Stat. Ann. tit. 15, §§ 165 and 170. NICOR is the promisor under the ARCs to pay escalated ceiling rates, and so is presumed to cause the uncertainty. Moreover, it drafted the GHK and Sun ARCs, Exh. 102 at 3, T. 455, 935, and "the language of the contract should be interpreted most strongly against the party who drafted the contract." *Dismuke*, 830 P.2d at 190.[24] NICOR also "caused the ambiguity" since in 1970 it wrote GHK stating that it would pay a "higher area field price" if approved, and "this makes it possible for you to obtain the maximum possible legal price." Exh. 6. The NGPA prices are such "maximum legal prices." Thus, FERC's contractual conclusions were consistent with Oklahoma case law and rules of construction.[25]

---

[24] *Dismuke* held that even with questions of law, the trial court must be affirmed "if there is any evidence . . . tending to support findings at law." *Id.* at 190. In a "contract action" the reviewing court must affirm the trial court "if supported by any probative evidence." *Morrow*, 612 P.2d at 732. Moreover, "the weight of the evidence is a question for the jury," and the factfinders' determinations are conclusive unless without *any* evidentiary basis. *Rain*, 293 P.2d at 362; *Dismuke*, 830 P.2d at 190; *NICOR* therefore failed to apply the proper *Oklahoma* standard of review.

[25] Oklahoma law also provides that a contract shall be interpreted to make it reasonable. Okla. Stat. Ann. tit. 15, § 159. FERC's result is reasonable, while *NICOR*'s is not, because the ARCs were conceded to permit congressionally-established NGPA prices, and the alleged "cost-based" limitation does not appear in the plain language of any of the contracts or in *any* of the contemporaneous documents (T. 328). Prior to the NGPA, Commis-

4. *NICOR* also committed plain error by misapplying the Oklahoma contract construction principles that it did employ. *NICOR* claimed (App. 12a) that FERC erred under Oklahoma law by focusing on one phrase of the ARCs without considering the clauses and contracts as a whole. However, FERC *did* consider the whole ARCs, by focusing on whether there is a reference to agency-established rates tied to a reference to the NGA or its J&R standard, *and* whether there is additional language uncoupling that link. App. 69a-75a. FERC found that the reference in the ARCs to rates set by a "successor governmental authority" broke any link in the ARCs between (a) the NGPA (or its J&R standard); and (b) agency-established rates. App. 74a-75a. FERC's construction of the ARCs also is consistent with the contracts' "Regulation" clauses which subject them "to all present and future valid laws." App. 124a-26a. Reading together the Regulation clause with the "successor governmental authority" language in the ARC clearly supports an intent to collect rates established by Congress in the NGPA, a "future valid law," and also complies with the Oklahoma rule that "[t]he whole of a contract is to be taken together . . . each clause helping to interpret the others." Okla. Stat. Ann. tit. 15, § 157. Thus, *NICOR* was wrong in claiming FERC did not consider both the ARCs and the contracts as a whole, as required by Oklahoma law.

VI. *NICOR* CONFLICTS WITH THIS COURT'S DECISIONS CONCERNING THE SCOPE OF AGENCY AUTHORITY UPON REMAND

NICOR held it would "vacate the Commission's order and remand the case to the Commission for entry of an order denying Scarth's request for a rate increase." App.

---

sion-established rates that reflected pricing *incentives* as well as cost, were paid under the three Scarth contracts. *See* p. 2, *supra*. Thus, *NICOR*'s imputation of a "cost-based" restriction is unreasonable, and effectively revises the contract by imputing a limitation to "cost-based" rates, though *"a court may neither make a new contract to benefit a party nor rewrite the existing one." Bonner*, 863 P.2d at 1183.

2a. Assuming, *arguendo*, that the *NICOR* decision was not unlawful, *see*, *supra*, the remand directive as to how FERC must exercise its NGA and NGPA statutory powers concerning a rate increase unlawfully usurps administrative discretion and contravenes this Court's precedents. In reviewing FERC orders, "the function of the reviewing court ends when an error of law is laid bare . . . . the matter [then] goes to the Commission for reconsideration." *FPC v. Idaho Power Co.*, 344 U.S. 17, 20 (1952). While a court " 'may thus correct errors of law and on remand the Commission is bound to act upon the correction,' " such action " 'does not impliedly foreclose the administrative agency, after its error has been corrected, from enforcing the legislative policy committed to its charge.' " *United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392, 406 (1965), *quoting*, *FCC v. Pottsville Broadcasting Co.*, 309 U.S. 134, 145 (1940). Having laid bare FERC's "error of law," the Fifth Circuit's duty ended, and it should have remanded the case for FERC to enforce the legislative policy of the NGPA and the NGA. *NICOR*'s mandate that FERC deny Scarth's § 108 rate request unlawfully forecloses any "reconsideration" by FERC of the matter.

CONCLUSION

Wherefore Scarth prays that a writ of *certiorari* issue to review the judgment of the Fifth Circuit.

Respectfully submitted,

BERNARD A. FOSTER, III
Counsel of Record
WILLIAM R. MAPES, JR.
G. WILLIAM STAFFORD
DEBORAH A. CARPENTIER
ROSS, MARSH & FOSTER
1401 H Street, N.W.
Washington, D.C. 20005-2110
(202) 822-8888
Counsel for Petitioners

October 3, 1995

APPENDIX A

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 94-40246

NICOR EXPLORATION COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

Petition for Review of an Order of the
Federal Energy Regulatory Commission

April 27, 1995

Before REYNALDO G. GARZA, DAVIS and BARKSDALE, Circuit Judges.

W. EUGENE DAVIS, Circuit Judge:

NICOR Exploration Company petitions this court to review a Federal Energy Regulatory Commission order granting Robert W. Scarth authority to collect incentive-based rates for natural gas pursuant to § 108 of the Natural Gas Policy Act ("NGPA"), 15 U.S.C. §§ 3301 *et seq.* The Commission concluded that the "area rate clauses" contained in gas supply contracts signed by NICOR and Scarth's predecessors authorize Scarth to collect § 108 rates. The central issue raised by NICOR

is whether the Commission's interpretation of the contracts conflicts with Fifth Circuit precedent and Oklahoma contract law. We agree that the Commission failed to properly apply state contract law in construing the area rate clauses and that, under state law, Scarth failed to satisfy his burden of proof. Accordingly, we vacate the Commission's order and remand the case to the Commission for entry of an order denying Scarth's request for a rate increase.

I.

In 1970, NICOR signed three gas supply contracts with Scarth's predecessors, GHK Co., Sun Oil Co., and the Amerada Hess Corporation (the "Producers"). Under the terms of the contracts, the Producers agreed to sell NICOR gas from the Green #1-1 Well located in Beckham County, Oklahoma. Between 1988 and 1989, Scarth purchased the Producers' interests in the three contracts and requested the Commission to reclassify the Green Well as a "stripper" well so that he could collect higher incentive-based rates under § 108 of the NGPA. NICOR filed a petition with the Commission opposing Scarth's rate increase.

The Supreme Court's *Mobile-Sierra* Doctrine prohibits the Commission from granting a rate increase to a producer unless the producer's contract authorizes a rate increase. *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332, 76 S.Ct. 373, 100 L.Ed. 373 (1956); *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 76 S.Ct. 368, 100 L.Ed. 388 (1956). While NICOR's contracts provided for a fixed initial price per unit of gas, each contract contained an area rate clause allowing the Producers to increase the contract price under certain circumstances. Scarth contends that these area rate clauses authorize the rate increase he requests. The area rate clauses are similarly worded:

> If the Federal Power Commission, or any successor governmental authority having jurisdiction in the

> premises, shall at any time hereafter prescribe, for the area in which the contract is located, a higher, applicable, just and reasonable area rate for the purchase of gas than the price herein provided to be paid, then the price to be paid by the Buyer to Seller for gas delivered under the provisions of this Agreement shall be increased to equal such higher price effective as of the date such higher price is made applicable to the gas sold hereunder.[1]

These clauses thus authorized the Producers to increase the contract price to match the maximum rate for the area established by the Federal Power Commission ("FPC"), the Commission's predecessor.

The scope of area rate clauses became a matter of extensive litigation with the passage of the NGPA in 1978. Prior to 1978, the FPC established "just and reasonable" area rates based on the producer's cost of service. The NGPA eliminated the FPC's power to set area rates and, in its place, established nation-wide statutory rate ceilings. Section 104 of the NGPA essentially adopted the FPC's cost-based methodology for setting the rates of most natural gas committed or dedicated to interstate commerce prior to 1978. 15 U.S.C. § 3314. However, § 108 of the NGPA establishes special "incentive-based" rates for low output "stripper" wells. 15 U.S.C. § 3318. These incentive-based rates are significantly higher than § 104's cost-based rates. Attempts by producers to obtain § 108 rates raised the issue of whether pre-NGPA area rate clauses authorized producers to collect higher NGPA incentive-based rates.

The Commission addressed the scope of pre-NGPA area rate clauses in three agency orders, Orders 23, 23-A, and 23-B ("Order 23"),[2] and in *Independent Oil & Gas*

---

[1] The only substantive difference is that the area rate clause in the Amerada Hess contract omits the phrase "just and reasonable."

[2] Order 23, 6 FERC (CCH) ¶ 61,229 (March 13, 1979); Order 23-A, 7 FERC (CCH) ¶ 61,247 (June 12, 1979); Order 23-B, 8

Ass'n of W. Virginia, 10 FERC ¶ 61,214 (1980) ("Opinion 77"). In Order 23, the Commission concluded that neither the language of the NGPA nor the Commission's regulations precluded producers from relying on pre-NGPA area rate clauses to obtain higher rates under § 108 of the NGPA. 6 FERC (CCH) ¶ 61,229. The Commission further concluded, however, that variations in the language and circumstances of these clauses prevented a uniform construction that would apply to all contracts. *Id.* The Commission thus opted for a case-by-case approach to interpreting area rate clauses. Since area rate clauses are "inherently ambiguous", the Commission decided that the focal point of its inquiry should be the mutual intent of the parties at the time the contract was signed. *Id.* In other words, the Commission would attempt to glean from extrinsic evidence whether the parties would have agreed to incentive-based rates if these rates had been available at the time the contract was signed. The Commission also established procedures for purchasers and third parties to protest rate increase requests. *Id.*

In Opinion 77, the Commission formulated specific guidelines for interpreting area rate clauses. Opinion 77 establishes a two-part inquiry for determining the parties' intent. First, the Commission must consider extrinsic evidence probative of intent, including the parties' negotiations, course of dealing, and other evidence of the circumstances surrounding the contract's execution. 10 FERC at 61,397. If the Commission finds "no reliable and probative evidence of intent" or if "such evidence is inconclusive," however, Opinion 77 requires the Commission to look to the language of the area rate clause and apply a three-prong formula to decide whether the clause allows § 108 rates:

FERC (CCH) ¶ 61,130 (Aug. 6, 1979). The Commission promulgated Rule 23 after extensive feedback and comment from gas producers, pipelines, and local distributors. The Fifth Circuit upheld the order in *Pennzoil Co. v. FERC*, 645 F.2d 360, 384 (5th Cir.1981) (*"Pennzoil I"*).

> In such situations, we will generally conclude that a contract containing an area or national rate clause does not authorize collection of all NGPA rates if it contains the following disqualifying terms:
>
> (1) it refers to rates established or prescribed by an administrative body;
>
> (2) it couples the reference to administrative action with a reference to the Natural Gas Act or the "just and reasonable" standard of that Act; and
>
> (3) it contains no additional language which has the effect of uncoupling the link between agency action and the statutory standard of the Natural Gas Act.

Id. at 61,398. According to the Commission, references to both administrative rate-setting and the NGA's "just and reasonable" standard generally indicate that the parties intend to limit price increases to cost-based rates. *Id.* On the other hand, the Commission concluded that language severing the link between administrative action and a cost-based standard suggests that the parties intend to allow price increases to the maximum rate allowed by statute, whether cost-based or incentive-based. *Id.*

Applying Opinion 77's methodology to NICOR's contracts, an administrative law judge ("ALJ") concluded that the area rate clauses did not authorize Scarth to collect § 108 incentive-based rates. 56 FERC ¶ 63,023 at 65,094 (1991). According to the ALJ, the extrinsic evidence of the parties' mutual intent failed to support Scarth's contention that the parties intended the area rate clauses to authorize rate increases up to the maximum level permitted by law:

> The course of performance evidence, as well as the evidence on the other items involving reliable and probative extrinsic evidence of the parties' intent, is clearly insufficient to support Scarth's contention that

> the [area rate clauses] in issue entitle it to collect payment of section 108 NGPA ceiling prices. . . . In sum, such evidence not only does not suffice to overcome Scarth's admitted burden of demonstrating . . . the contracting parties' intent to pay and collect incentive-based NGPA section 108 rates, but rather supports the conclusion that the [clauses] in question contemplated payment and collection of only cost-based prices.

The ALJ also applied Opinion 77's three-prong formula and found that the language of the area rate clauses satisfied the formula's three elements.

The Commission initially affirmed the ALJ's order. 58 FERC ¶ 61,203 (1992). On motion for rehearing, however, the Commission reversed its earlier order and concluded that NICOR's area rate clauses authorize Scarth to collect incentive-based rates under § 108. 63 FERC ¶ 61,034 at 61,184-61,186 (1993). The Commission first found that the parties' extrinsic evidence of mutual intent was inconclusive as to whether they intended the area rate clauses to authorize rate increases up to the maximum level permitted by law. The Commission then applied Opinion 77's three-part formula to the language of the area rate clauses. The Commission concluded that the area rate clauses authorized § 108 rates because each clause failed to satisfy one or more elements of Opinion 77's formula. *Id.*

According to the Commission, the area rate clause in the Amerada Hess contract failed to refer to the NGA or to the "just and reasonable" standard as required by the second prong of the formula. The Commission further concluded that the area rate clauses in the GHK and Sun contracts similarly allowed § 108 rates because the presence of the phrase "any successor or governmental authority" uncoupled the link between the contracts' references to administrative action and the "just and reason-

able" standard.[3] According to the Commission, this language is consistent with Congressionally-established rates under the NGPA.

NICOR requested judicial review of the Commission's final order pursuant to 15 U.S.C. §§ 717r(b) and 3416 (a)(4). We granted Robert W. Scarth's motion to intervene in support of Commission's order.

II.

NICOR maintains that the Commission's application of Opinion 77's methodology in the present case conflicts with Fifth Circuit precedent and Oklahoma contract law. NICOR contends that the Commission failed to follow state law in construing the area rate clauses as required by this court's decision in *Pennzoil Co. v. FERC*, 645 F.2d 360, 384 (5th Cir.1981) (*"Pennzoil I"*). Before addressing the merits of NICOR's petition, however, we must first address a threshold jurisdictional issue raised by Scarth.

A.

As a preliminary matter, Scarth questions whether NICOR properly preserved the arguments raised in its petition. Scarth contends that NICOR waived these arguments when it failed to file any objections to the ALJ's initial order. Although the ALJ ruled in favor of NICOR, Scarth points out that the ALJ relied on the same methodology that NICOR now assails.

---

[3] The Commission expressly addressed the impact of this type of language in Opinion 77:

> Such an uncoupling could occur, for example, where a reference to the Natural Gas Act or the "just and reasonable" standard is supplemented by the phrase "or successor statutory authority" or words of similar import. In this circumstance, the parties commit their contractual destiny to a change in the statutory scheme and give advance acceptance to the outcome of the legislative process.

Scarth bases his waiver argument on 15 U.S.C. § 717r (b). Section 717r(b) grants courts of appeal original jurisdiction to review final orders issued by the Commission. However, this section further provides that "[n]o objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing." This waiver provision is construed as a strict jurisdictional limitation on this court's power to review the Commission's orders. *Tennessee Gas Pipeline Co. v. FERC*, 871 F.2d 1099, 1107 (D.C.Cir.1989).

Our review of the record persuades us that Scarth's waiver argument is without merit. Although NICOR failed to raise any objections to the ALJ's application of Opinion 77 or to the Commission's initial order affirming the ALJ's decision, NICOR raised its objections in a motion for rehearing following the Commission's final order reversing the ALJ and ruling against NICOR. Until that point in the proceeding, NICOR was the prevailing party. We reject Scarth's claim that § 717r(b) requires a prevailing party to file objections to a favorable ruling by an ALJ in order to preserve its right to appeal if the ALJ's decision is later reversed by the Commission. As long as a party in Nicor's position presents its objections to the Commission in a timely motion for rehearing, § 717r(b)'s requirements are satisfied. We therefore conclude that NICOR properly preserved the issues raised in its petition by timely raising its objections in its motion for rehearing following the Commission's final order. We now turn to the merits of NICOR's argument that the Commission failed to follow Oklahoma law in interpreting the area rate clauses.

B.

In *Pennzoil I*, we held that the Commission must apply state contract law in construing gas supply contracts. 645 F.2d at 387. While the court recognized that the

Commission may formulate and apply "general principles of contract law" to construe area rate clauses, "specific determinations of contractual authority in the [commission's] protest procedures must take account of and follow any differences with general contract law that the appropriate state contract law may have." *Id.* at 383-84. In deciding which state's law applies, the Commission should apply the state law that would "govern the parties' dealings were there no regulation at all of the contract's subject matter." *Id.* at 387.

NICOR contends that the Commission's application of Opinion 77's interpretive standards runs afoul of *Pennzoil I* because it is inconsistent with Oklahoma contract law. NICOR focusses on two aspects of the Commission's methodology that it argues are inconsistent with Oklahoma contract law. First, NICOR faults the Commission for basing its interpretation solely on language in the area rate clauses that the Commission admits is ambiguous without also considering the extrinsic evidence of the parties' intent. Second, NICOR contends that the Commission's methodology essentially relieved Scarth of his burden of proving that the area rate clauses permit § 108 rates.

We must address NICOR's contention that Oklahoma contract law governs the interpretation of the area rate clauses at issue. In *Pennzoil I*, we held that the choice of which state's law to apply "is properly a matter within federal common law." 645 F.2d at 387. NICOR contends that Oklahoma law governs because the three contracts were negotiated and signed in Oklahoma, and because the subject matter of the contracts concerns gas produced from an Oklahoma well. Moreover, neither Scarth nor the Commission dispute the applicability of Oklahoma law, and none of the contracts contain forum selection clauses.

Although we are not bound by Oklahoma choice of law rules, these rules may guide us in deciding whether Okla-

homa law should apply in the present case. Oklahoma choice of law rules for contracts require courts to apply "the law of the state (1) chosen by the parties, (2) where the contract was entered into, or (3) the place of performance if indicated in the contract." *Moore v. Suburu of America,* 891 F.2d 1445, 1449 (10th Cir.1989) (internal citations omitted). Because of Oklahoma's extensive contacts with the three contracts, we agree that Oklahoma law should apply.

Turning to the Commission's application of Oklahoma law, we generally do not defer to the Commission's interpretation of gas supply contracts unless the Commission relied on its factual or technical expertise in reaching its conclusions. *Tennessee Gas Pipeline Co. v. FERC,* 17 F.3d 98, 102 (5th Cir.1994). Deference is not appropriate where the Commission relies "solely on the words of the contract," or where the central issue before the court is the Commission's application of state law. *Id.; Pennzoil Co. v. FERC,* 789 F.2d 1128, 1135 (5th Cir. 1986) (*"Pennzoil II"*). In such cases, the construction of a contract is not "enhanced by the agency's expert understanding of the industry." *El Paso Natural Gas Co. v. FERC,* 881 F.2d 161, 164 (5th Cir.1989). Because NICOR's objections focus on the Commission's application of Oklahoma state contract law, the Commission's construction of the area rate clauses in this case is not entitled to deference. We therefore review the Commission's order *de novo.*

We agree with NICOR that the Commission's application of Opinion 77 to the present case conflicts with Oklahoma contract law. Oklahoma law directs courts to consider extrinsic evidence of the parties' mutual intent in cases where the language of a contract is ambiguous. *See Mercury Investment Co. v. F.W. Woolworth Co.,* 706 P.2d 523, 529 (Okla.1985); Okla.Stat.Ann. tit. 15, § 152 (West 1993). Extrinsic evidence relevant to determining

the parties' intent includes the circumstances surrounding the execution of the contract and the parties' negotiations. *Public Service Co. of Okla. v. Home Builders Ass'n of Realtors, Inc.*, 554 P.2d 1181 (Okla.1976). Oklahoma's version of the Uniform Commercial Code ("UCC") similarly provides that courts should construe ambiguous contracts with reference to the parties' course of dealing and course of conduct. Okla.Stat.Ann. tit. 12A, §§ 1-205, 2-202.

The Commission failed, however, to give any weight to the extrinsic evidence of the parties' intent in concluding that NICOR's area rate clauses authorized § 108 rates. While the Commission initially considered extrinsic evidence concerning the parties' negotiations and course of dealing, the Commission concluded that this evidence was inconclusive. The Commission then construed the area rate clauses solely on the basis of the language of the clauses and Opinion 77's three-part formula:

> Since the Commission found that none of the parties produced such evidence of mutual intent, the Commission affirmed the ALJ to that extent and, like the ALJ, resolved the matter solely by application of the interpretive standards.

66 FERC at 61,769.

In construing the language of area rate clauses, however, the Commission must consider "*all* evidence—contract language, oral and written extrinsic evidence and evidence of course of performance." *Hunt Oil Co. v. FERC*, 853 F.2d 1226, 1237 (5th Cir. 1988) (emphasis in original). This evidence must "be *balanced* to determine the parties' intent." *Id.* In *Hunt Oil*, we reversed the Commission's interpretation of an area rate clause based on the Commission's failure to consider extrinsic evidence of intent. As in the present case, the Commission concluded that the extrinsic evidence of the par-

ties' intent was inconclusive and thus based its interpretation solely on the language of the clauses.[4] We concluded that the Commission's methodology was defective because "*Pennzoil I* does not permit ambiguities or conconflicts to negate consideration of any part of the overall picture." *Id.* The Commission thus erred in discarding the extrinsic evidence in the instant case based on its conclusion that the evidence was "inconclusive."

The Commission's approach is also inconsistent with state law to the extent that it narrowly focuses on specific phrases in the area rate clauses without considering the language of the clauses and contracts as a whole. Oklahoma law requires courts to consider a contract as a whole "without narrowly concentrating upon some phrase or language taken out of context." *Bonner v. Oklahoma Rock Corp.*, 863 P.2d 1176, 1184 (Okla.1993); *see also* Okla.Stat.Ann. tit. 15, § 157. The Commission acknowledged that the references to administrative rate-making and the "just and reasonable" standard in the GHK and Sun contracts supported NICOR's contention that the contracts did not authorize § 108 incentive-based rates. However, the Commission decided that the contracts authorized § 108 prices based on the presence of the phrase "successor governmental authority." Thus, the Commission essentially treated this phrase as dispositive without considering the language of the area rate clauses as a whole.

Finally, we agree that the Commission erred by relieving Scarth of his burden of proving by a preponderance of the evidence that the area rate clauses authorized § 108 rates. In applying Opinion 77, the Commission essentially shifted the burden of proof by requiring NICOR to prove the absence of contractual authority for § 108 rates. The ALJ concluded that Scarth failed to

---

[4] *Hunt* does not indicate whether the Commission applied Opinion 77's three-prong formula.

satisfy his burden of proof with regard to the extrinsic evidence of intent. Although the Commission accepted this finding, it applied Opinion 77's three-part formula because NICOR failed to prove that the parties mutually intended to limit rate increases to cost-based rates:

> Scarth failed to prove a mutual intent to authorize the payment of incentive rates. However, *this also means that NICOR did not prove by a preponderance of the evidence that the parties had the mutual intent to limit area rate clause price escalations to only cost-based rates.* Under the procedures established in Opinion 77, to win the case at the evidentiary stage and not reach the interpretive standards, NICOR had to prove by extrinsic evidence that its alleged intent was shared by each of the producer/sellers.

66 FERC at 61,771 (emphasis added). Moreover, in applying Opinion 77's interpretive formula, the Commission essentially created a presumption in favor of Scarth. The Commission held that, as a general rule, area rate clauses authorize § 108 rates unless the language of the clauses satisfy all three prongs of Opinion 77's interpretive formula. 63 FERC at 61,184.

The Commission's allocation of the burden of proof conflicts with this court's holding in *Pennzoil I* that the producer bears the burden of proving that an area rate clause authorizes incentive-based rates under the NGPA. 645 F.2d at 370. Scarth's failure to prove by a preponderance of the extrinsic evidence that the parties mutually intended to allow non-cost-based rates would have resulted in a judgment in favor of NICOR in Oklahoma state court. *See* 5A Corbin on Contracts § 1230 at 511 (1964). When the Commission relieved Scarth of this burden by turning to Opinion 77's interpretive formula, the Commission failed to comply with *Pennzoil I* and state contract law.

We conclude, therefore, that the Commission failed to follow state contract law in construing NICOR's area rate clauses. Based on the findings in the ALJ's order and the Commission's original order affirming the ALJ, Scarth failed to prove by a preponderance of the evidence that the contracting parties intended to authorize § 108 prices. Scarth thus failed to meet his burden of proof under Oklahoma contract law and *Pennzoil I*. We therefore VACATE the Commission's order and REMAND the case to the Commission for entry of an order denying Scarth's request for a rate increase. *See Hunt Oil*, 853 F.2d at 1233.

VACATED and REMANDED.

APPENDIX B

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Docket No. GP90-11-000

IN THE MATTER OF NICOR EXPLORATION COMPANY

INITIAL DECISION

(Issued September 24, 1991)

Max L. Kane, Administrative Law Judge.

Procedural History

The issue requiring resolution in this case has been the subject of considerable litigation in other proceedings. In simple terms it involves contract interpretation in order to determine whether the area rate clauses ("ARCs") in the contracts in question provide authority for payment of non cost-based prices entitling Scarth Oil and Gas Company ("Scarth") to receive the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. § 3301-3432, section 108 ceiling price.

The original gas purchase contracts, the subject of the instant proceedings, were executed in 1970 between NI-Gas Supply, Inc. (NICOR Exploration Company's predecessor-in-interest) ("NI-Gas" or "NICOR"), as purchaser, and (1) Sun Oil Company ("Sun"), (2) the GHK Company (formerly the Glover Hefner Kennedy Oil Company) ("GHK") and (3) Amerada Hess Company ("Amer-

ada"), as producer/sellers. The producers contracted to sell gas from the Green #1-1 well in Beckham County, Oklahoma ("Green Well"). In late 1988, Scarth acquired the working interests and gas sales rights of the producer/sellers in the Green Well.

On July 11, 1990, NICOR filed a protest under section 157.40(c)(v)(B) of the Commission's regulations requesting that the Commission determine that the area rate clauses do not provide the necessary contractual authorization to entitle Scarth to collect incentive prices under the National Gas Policy Act. In its answer to NICOR's protest, Scarth moved for leave to intervene and to dismiss or in the alternative, for summary denial.

After various procedural proceedings, by order dated November 1, 1990, the Chief Administrative Law Judge granted Scarth's motion to intervene and designated me to preside over the proceedings, directing me to determine whether a hearing on NICOR's protest was necessary and if necessary, to issue an Initial Decision on the merits.

In accordance with my order of November 13, 1990, I presided at a prehearing conference on November 27, 1990, at which time, after hearing argument by the parties' counsel, I set an agreed-upon procedural schedule for hearing. On December 7, 1990, I issued an order formerly denying Scarth's motion to dismiss NICOR's protest. After the filing of the parties' testimony, (staff did not file any), the hearing on controversial issues commenced on April 22, and concluded on May 8 after a brief intervening recess. The record evidence consisted of the testimony of four witnesses on behalf of Scarth, and six witnesses presented by NICOR. In accordance with unanimous agreement, simultaneous initial briefs were filed by the parties, including Commission staff, on June 25, and reply briefs were filed on July 26.

Positions of the Parties

Scarth contends that it is entitled to the NGPA section 108 ceiling price under the GHK, Sun, and Amerada contracts because the intent of the parties at the time of contracting was that the area rate clauses would provide entitlement to the highest rate permitted by law. In support of this contention, Scarth argues that the testimony of the producers has shown that it was their intent for the area rate clauses to provide entitlement to the highest rate permitted by law and the commercial and regulatory contexts in which NICOR negotiated the Green contracts support its position to the effect that the parties to the contracts intended the area rate clause to cover any rate permitted by law, including non-cost-based rates.

Conversely, NICOR argues that the area rate clauses in the subject contracts provide contractual authority only for the collection of cost-based rates, and not only was there no mutual intent to provide for non-cost-based prices, but the course of performance between the parties and the usage of trade in existence at the time of the contract negotiations show that the parties intended the area rae clauses to cover only cost-based rates.

Staff supports NICOR's position maintaining that Scarth has failed to demonstrate by a preponderance of the evidence that the parties to the contracts, at the time of execution, intended to pay and collect prescribed incenive-based NGPA section 108 rates. Rather, the contract language, the testimony of the parties and the parties' course of performance—both prior and subsequent to the enactment of the NGPA—supports the conclusion that the contracting parties intended only to permit cost-based price increases.

Discussion

In resolving the contractual issue before me, I have considered the fact that the original contracts were en-

tered into by the parties involved with full consideration of the impact of the provisions on them. The evidence clearly indicates that the parties were represented by seasoned experts who interacted with each other and understood the nature as well as the extent of the provisions of that agreement.

The parties are in agreement that Scarth has the burden of proof to demonstrate by a preponderance of the evidence that pursuant to the ARCs in the contracts it has contractual authority to collect NGPA section 108 rates for gas produced from the Green Well.

In the Order No. 23 series, the Commission established a test to determine whether a particular area rate clause provided contractual authority for the payment and collection of NGPA ceiling prices. *FERC Statutes and Regulations* ¶ 30,040, *reh'g*, 7 FERC ¶ 61,152 (1979); Order No. 23-A, *FERC Statutes and Regulations* ¶ 30,058, *reh'g*, 8 FERC ¶ 16,158 (1979); Order No. 23-B, *FERC Statutes and Regulations* ¶ 30,065, *reh'g*, *FERC Statutes and Regulations* ¶ 30,073 (1979). The Commission stated that because area rate clauses often vary in their language and intent, the language of the clause itself and the mutual intent of the contracting parties should be used to determine the meaning of the clause. *FERC Statutes and Regulations* ¶ 30,040, at p. 30,313. In Opinion No. 77, the Commission clarified this approach by setting out general guidelines for ascertaining the intent of the parties. *Indep. Oil and Gas Ass'n of West Virginia*, 10 FERC ¶ 61,214 (1980).

The parties agree that Scarth's contractual authority is dependent upon the determination of the intent of the contracting parties at the time the contracts were entered into. In a case such as this, where the parties are unable to agree on the interpretation of the area rate clause, the facts should be considered within the ambit of the Commission's Opinion No. 77, starting first with an analysis of the contract language. 10 FERC at p. 61,398. In

referring to that opinion, the Commission subsequently opined that "where the parties to the contract could not agree as to the meaning of the clause [ARC] and where the contract is not free from ambiguity, the Commission would rely on 'reliable and probative extrinsic evidence of the parties intent.'" *Equitable Gas Company*, 20 FERC ¶ 61,048, at p. 61,101 (1982) (*quoting Indep. Oil and Gas Ass'n of West Virginia*, 10 FERC at p. 61,397). Furthermore, as summarized by the Commission, such "reliable and probative" extrinsic evidence should include "[a]ll evidence—contract language, oral and written extrinsic evidence and evidence of the course of performance—[and such evidence] must be weighed to determine the parties' intent." *Northern Natural Gas Company*, 50 FERC ¶ 61,228, at p. 61,930 (1990). (citations omitted).

In accordance with the Commission's guidelines, the intent of the parties in this case has been determined against the backdrop of the testimony of the witnesses who were engaged in the negotiations involving the contracts in issue, the performance of the parties in executing the terms of the contracts, and the effect, if any, of the alleged industry practice at the time the contracts were entered into.

The ARCs in the Sun and GHK contracts are identical and state as follows:

> If the Federal Power Commission, or any successor governmental authority having jurisdiction in the premises, shall at any time hereafter prescribe, for the area in which the contract acreage is located, a higher, applicable, just and reasonable area rate for the purchase of gas than the price herein provided to be paid, then the price to be paid by Buyer to Seller for gas delivered under the provisions of this Agreement shall be increased to equal such higher price effective as of the date such higher price is made applicable to the gas sold hereunder.

Ex. No. 1 at 29-30; Ex. No. 2 at 31.

The Amerada ARC, while not identical, is deemed to be similar in effect, and the differences not significant according to witnesses Cook of Amerada Hess and Maurath of NICOR. Ex. No. 90 at 7; Ex. No. 30 at 4:

> If the Federal Power Commission, or any successor governmental authority having jurisdiction over the sale of Gas hereunder, at any time thereafter prescribes or permits, by order following hearing, or by settlement, for the area in which the Gas Reserves are situated, an applicable higher price for the sale of gas than the price being paid hereunder at the time, then the price for Gas delivered hereunder will be increased effective as of the date such higher price is prescribed or permitted to equal such higher price.

Ex. No. 3 at 17.

The Commission has attempted to give guidance in arriving at the proper interpretation of area rate clauses which contain a reference to "just and reasonable rates." Initially, it stated:

> [t]he long-standing practice of the FPC and of this Commission has been to set those rates under a cost-based methodology and in the context of an agency proceeding in which affected parties have been afforded the opportunity to participate. If the parties to a contract meant to incorporate these traditional regulatory features into their agreement, it would be inconsistent with their agreement to find that the contract authorized collection of all NGPA rates.

10 FERC at p. 61,397.

In the instant proceedings, there is no reliable and probative evidence sufficient to ascertain the mutual intent of the parties and the evidence of such intent might be deemed inconclusive. In Opinion No. 77, the Commission held that:

> [i]n such situations we will generally conclude that a contract containing an area or national rate clause does not authorize collection of all NGPA rates if it contains the following disqualifying terms:
>
> (1) It refers to rates established or prescribed by an administrative body;
>
> (2) It couples the reference to administrative action with a reference to the Natural Gas Act or the "just and reasonable" standard of the Act; and
>
> (3) It contains no additional language which has the effect of uncoupling the link between agency action and the statutory standard of the Natural Gas Act.
>
> If all of the above three factors are present, the Commission will interpret the contract to authorize collection of only those NGPA rates which are cost-based, namely, those provided in §§ 104 and 106(a). If these disqualifying terms are not *all* present, we would generally find that an area rate or national rate clause authorizes NGPA rates.

Id. at p. 61,398.

I agree with staff's conclusion that in utilizing the interpretive standards set out in Opinion No. 77, the language of the ARCs in issue, as well as the circumstances surrounding their negotiation and execution, authorize only cost-based rates. Staff IB at 48. The language of the Sun and GHK area rate clauses specifically refers to administrative action by the "Federal Power Commission or any governmental authority having jurisdiction in the premises" and to "applicable just and reasonable area rate." The Amerada contract also couples references to "Federal Power Commission or any successor governmental authority having jurisdiction over the sale of gas hereunder . . . for the area in which the Gas Reserves are situated" and neither clause contains additional language uncoupling the

administrative action and the cost-based standard of the Natural Gas Act.

Scarth's contention that "the Opinion No. 77 three-step test is not applicable here where the record contains conclusive reliable and probative evidence supporting Scarth's position," Scarth IB at 22, is rejected. The record does not contain "conclusive reliable and probative evidence" necessary to support Scarth's position.

The Parties' Testimony of Intent

Notwithstanding the conclusion that within the parameters of Opinion No. 77, only cost-based rates were intended, the same conclusion may be arrived at from the examination of the probative and reliable testimony of intent that was adduced at the hearing.

In the instant proceedings, we are fortunate in having testimony from witnesses who were involved in the negotiation and execution of the contracts in question. Scarth's witnesses include J.W. Strickland who was Assistant Superintendent of Operations of the Mid-Continent Division of Sun Oil Company and negotiated the Green Contract with NICOR, and Donald W. Cook who was in charge of the administration of all Amerada Hess gas sales and contracts and participated in the contract negotiations of Amerada Hess' Green contract.

NICOR's witnesses, Daniel Parson and Robert Maurath were the principal negotiators of the Green contracts. In addition, Robert A. Hefner III, the Chairman of GHK, who negotiated the NI-Gas/GHK contract, supported the testimony of the NICOR witnesses, Parson and Maurath.

Although Strickland and Cook testified concerning the general corporate policy of the companies involved in the original contract negotiations, neither witness testified about the details of the contract negotiations. Strickland was unable to remember the specifics, instead he based his conclusion on notes and correspondence to the effect

that it was Sun's intent to permit collection of the highest price or rate allowed by any governmental authority for production, regardless of how the rate or price was determined. Ex. No. 102 at 1-3; Tr. at 908. The witness Cook was also unable to remember the specifics of the Green contract negotiations, instead, he based his conclusions on the general corporate policy to the effect that Amerada Hess used the area rate clause to establish a contractual basis for collection of the highest gas prices which the law would allow. Ex. No. 90 at 4.

Because it is virtually impossible to determine whether Sun and Amerada Hess adhered to the general corporate policy in the negotiation of the contracts in question, the testimony of Scarth's witnesses is in sharp contrast to the more accurate testimony of the NICOR witnesses. According to their testimony, Parson and Maurath negotiated the contracts and were able to recall the circumstances surrounding the execution of those contracts. Thus, Parson testified that Northern Illinois Gas Company, instructed NI-Gas Supply, a subsidiary, that in purchasing the gas on its behalf, NI-Gas should emphasize that it would only pay cost-based rates. Tr. at 332. Parson "emphasized [to representatives from Sun, Amerada Hess, and GHK] that NI-Gas Supply Inc. could only agree to pay cost-justified rates and that the area rate clauses would cover only such rates as were approved in the future as just and reasonable by the Federal Power Commission." Ex. No. 7 at 2. He testified that it was not necessary for producers and purchasers to explain what the words of a standard area rate clause meant because "[w]e all understood that an area rate clause is what the FPC had ruled an area rate clause was and that area rate clauses by their nature under the FPC decisions were cost-based." Tr. at 335. Furthermore, NI-Gas never considered, in 1969, 1970, that the FPC might permit price increases on a standard other than the just and reasonable basis, Tr. at 336, and consequently, NI-Gas didn't believe it necessary to insert a condition in the area rate clause stating that

NI-Gas would pay only cost-based price increases "because area prices by their nature were cost-based." Tr. at 335.

In the same vein, Maurath, the other NICOR witness who was involved in the contract negotiations, testified that in his opinion the negotiation of an area rate clause was the same for buyers and sellers. Tr. at 457. "An area rate clause is cost-oriented, cost-based, cost-of-service." In the mid 1960s, the term cost-of-service was used more often than cost-based, "but it [cost-based] is inherent in the definition of the term area rate clause." Tr. at 458.

The cost-based ideology espoused by Parson and Maurath was reinforced by the witness Hefner, who on behalf of GHK, was involved in the negotiations and execution of the GHK contract. He testified that the testimony of Maurath and Parson accurately stated the exact intentions they expressed at the time they entered into the contract. Ex. No. 21 at 7. Mr. Hefner also testified that he suspected NI-Gas' intent was made "fairly clear" to GHK at the time of the contract negotiations, Tr. at 403, but that GHK was willing to negotiate with NI-Gas for the sale of the Green production because "although they would only pay area rate price, NI-Gas would be willing to make non-price concessions to do the deal." *Id.* at 4.

Scarth's witness, Robert W. Scarth, President of Scarth Oil and Gas Company, also testified concerning what he believed, based on counsel's advice, that the area rate clauses were standard and permitted payment of section 108 rates. Ex. No. 53 at 6. It is well to note that Scarth became involved in the purchase of the Green well in 1988; and nothing in his testimony would impinge upon the intent of the parties at the time the contracts were entered into. Consequently, such testimony does not in any way contradict or affect the cost-based testimony espoused by NICOR's witnesses.

Scarth has failed to persuasively support its argument that "the absence of the phrase 'cost-based' in any negotiation discussions or documents is particularly harmful to NICOR's position in this proceeding." Scarth RB at 12. The testimony of the witnesses clearly established that the reason for the absence of the language "cost-based" from the negotiations was the fact that the parties believed that it was not necessary because it was inherent or part of the definition of area rate pricing, which everyone understood was cost-based. Tr. at 298. In this connection the witness Maurth testified that the phrase cost-based rate was not specifically mentioned in the negotiations of the area rate clause because "[i]t was just inherent in area price to me, part of the definition of area price," Tr. at 461, and "if they had raised the question that cost-based can't continue, then we would have had a hang-up. We would have had a deal breaker. We probably wouldn't have moved." Tr. at 489.

Scarth's contention, that NICOR's failure to communicate to the other parties that it intended the clause to allow only cost-based pricing should be construed to establish the absence of such intent, is also not convincing. While it may be true that the intent of one party to a contract, not expressed or communicated to the other, may not be deemed proof of mutual intent, it is equally true that in the absence of proof that it was not that party's intent, such mutual intent cannot be attributed to that party. There is no substantive or material evidence in this case to substantiate Scarth's claim that NICOR did not intend to have the area rate clause include only cost-justified rates. On the contrary, the testimony of NICOR's witnesses, Parson, Maurath and Hefner, supports the contrary conclusion, that NICOR intended to pay only cost-justified rates and that the area rate clauses were intended to include only such rates.

Trade and Industry Usage

As indicated *supra*, one of the elements to be weighed in determining the intent of the parties who negotiated and executed the area rate clauses in question, is the effect of the usage of trade in the natural gas industry at the time of the execution of the contract. In this connection, it is well to note that the Commission has unmistakably stated its position to the effect that it "has never found that the usage of trade in the naural gas industry is that all area rate clauses would authorize the highest regulated price. Indeed, as noted in Order No. 23, the Commission found just the opposite." *Equitable Gas Company*, 20 FERC at p. 61,101.

Scarth's testimony to establish industry interpretation of the effect of area rate clauses was espoused by the expert witness, Mr. Jack Earnest. He testified "concerning the use and interpretation in the natural gas industry of area rate clauses, . . . [s]pecifically, . . . whether there is and was in the late 1960's through early 1970's a regularity of observance among sellers and purchasers of natural gas concerning the operation and effect of area rate clauses." Ex. No. 79 at 1. It was Earnest's opinion that "these area rate clauses were the standard form for the 1960-1970 period and would provide entitlement to the maximum rate permitted by law, including NGPA section 108 rates for gas which qualified under that section of the NGPA." "There is no language limiting the area rate clause to cost-based rates." *Id.* at 26.

Contrary to the witness Earnest's testimony, Mr. Kenneth A. Williams, former Assistant to the Chief, Pipeline Division, Bureau of Natural Gas, Federal Power Commission, testified that in 1969-1970, producers and interstate pipelines knew that the only basis for any area rate clause was a cost basis, and that, absent deregulation, there was no basis for assuming anything other than a cost-basis for the price. Tr. at 610. It was his view that "any producer or purchaser contracting in the late 1960's or

early 1970's with respect to gas to be transported and sold in interstate commerce reasonably could assume that prices for gas under those contracts would remain cost-based . . ." Ex. No. 49 at 12. He stated further that area rate clauses such as those contained in the Sun, Amerada and GHK contracts were considered contractual authority enabling producers to collect and purchasers to pay prices determined to be just and reasonable by the FPC or a successor agency. "Just and reasonable was a term of art that was generally synonymous with cost-based regulation." *Id.* at 10.

While persuasive, the testimony of NICOR's witness Mr. Parson is possibly not of the same probative value as the expert testimony with respect to the prevailing trade usage at the time the ARCs at issue were executed. In response to Earnest's testimony, it was Parson's opinion, based upon his long experience in the industry, that there was no such general industry understanding applying among gas distribution companies in the late 1960's and early 1970's that an area rate clause authorized the highest price allowed by law. Ex. No. 7 at 3. Furthermore, "the Green #1-1 project was one of the first instances in which a major distribution company negotiated directly with producers for system supply gas, so there were no industry practices." *Id.* at 4.

From an examination of the testimony relating to trade usage, it appears that NICOR's testimony was equally, if not more, persuasive than Scarth's trade usage presentation. In any event, the record evidence concerning industry trade practice and its effect on consideration of the scope of the ARCs in issue, falls far short of overcoming the Commission's conclusion in Order No. 23, *supra*, that ARCs do not automatically permit escalation to NGPA ceiling prices. Accordingly, Scarth's contention, that the commercial context in which the clauses were executed supports its position that "[t]he producer's and

NICOR's intent in 1969-1970 was to pay the highest legal rate without limitation," Scarth IB at 22, is rejected.

Course of Performance Evidence

The Commission has stated that "to determine proper ARC meaning extrinsic evidence of the commercial and regulatory context as well as the parties' course of dealing during the time when ARCs were negotiated, must be evaluated." *Northern Natural Gas Company*, 43 FERC ¶ 63,015, at pp. 65,154-65,155 (1988), *aff'd* 48 FERC ¶ 61,177 (1989), *reh'g denied* 50 FERC ¶ 61,288 (1990), *aff'd sub-nom. South Dakota Public Utilities Comm'n v. FERC*, 934 F.2d 346 (D.C. Cir. 1991), *reh'g denied* 1991 U.S. App. Lexis 18865 (Aug. 20, 1991).

Accordingly, we now turn to a consideration of the parties' course of performance under the contracts in question in order to determine whether the parties, by their actions, intended to be subject only to cost-based pricing, as contended by NICOR or payment of section 108 NGPA ceiling prices, as contended by Scarth.

In dealing with this issue it is well to note that there is no material evidence in the record indicating that NICOR had previously paid other than cost-based prices. Scarth contends that "NICOR has paid the applicable ceiling price under its Green producer contracts (except for Scarth's claim for NGPA Section 108 rates) without regard to whether those ceiling rates were cost-based or based on cost and non-cost factors." Scarth IB at 53. Scarth states that this history of payment "clearly demonstrates NICOR's true intent under the area rate clauses, contrary to its protests in this proceeding." *Id.* at 54. The testimony which is the basis for this conclusion is the statement by Mr. Bradley J. Fairhurst, accountant for NICOR, that the "prices paid from 1970 until enactment of the NGPA were consistent with the applicable Federal Power Commission ceiling prices and thereafter through March, 1989, the prices were consistent with Section 104

of the Natural Gas Policy Act." Ex. No. 43 at 2. Staff contends, and I agree, that until enactment of the NGPA, NI-Gas consistently paid the applicable FPC ceiling prices for the Green gas, which were always cost-based, and thereafter paid Section 104 rates which were also cost-based. Staff RB at 24-25.

Scarth contends that the "history of payment of the maximum rate the law would allow for the Green production, without regard to the method by which that ceiling rate was established, clearly demonstrates NICOR's true intent under the area rate clauses, contrary to its Protest in this proceeding." Scarth IB at 54. In support of its conclusion, Scarth refers to (1) the testimony of Mr. Strickland concerning Sun's belief that it was entitled to, and was receiving all applicable NGPA rates; and (2) NICOR's dealing with Mobil involving NICOR's payment to Mobil of ceiling prices, which prices were based on both cost and non-cost factors. Ex. 102 at 2, 5; Scarth IB at 55.

With respect to Mr. Strickland's testimony, it is apparent from the cross-examination that the NGPA rates he was referring to were those that the "well qualified for" and that "if it was qualified as a 104 well, that is the price we were receiving." Tr. at 942. As the staff points out, "[t]he Commission and the courts have made clear that NGPA section 104 rates are different than [sic] section 108 incentive rates since the NGPA section 104 rates are 'based and inextricably linked to' previously prescribed FPC cost-based rates." Staff RB at 9 (*citing Pennzoil Co. v. FERC*, 645 F.2d 369 at 380, n.39 and n.45 (5th Cir. 1981), *cert. denied* 454 U.S. 1142 (1982) ("*Pennzoil I*"); *Colorado Interstate Gas Co.*, 44 FERC ¶ 61,023, at p. 61,084, n.15 (1988)).

Furthermore, although Scarth presented evidence that NICOR has paid ceiling prices to Mobil which were based on both cost and non-cost factors, Scarth IB at 55, such action does not in any way show NICOR's course of

performance with respect to the Sun, GHK, or Amerada Hess contracts. As stated by NICOR, "[a]ctions by one party under a different contract are not 'course of performance' evidence under the Uniform Commercial Code." NICOR RB at 21. The *quid pro quo,* involved in some contract negotiations cannot be attributed to parties involved in other contract negotiations. Certainly, agreement on one set of pricing formulas in one contract cannot be assumed to be the basis of other contracts, even if one of the parties is the same in both sets of contracts.

In an effort to refute Scarth's contention that NICOR's course of performance supports the conclusion that the contracting parties' intent was to permit the collection of the highest price allowed by law, NICOR focused on proposals made by the parties to amend the contracts. Thus, in response to correspondence from the Sellers' requesting authorization to make expenditures for workover of the Green Well and suggesting a price increase for the gas, NICOR's witness Maurath set out the circumstances under which NI-Gas could agree to support a price increase. Ex. No. 30 at 6, Ex. Nos. 31-33. Maurath made it clear that NI-Gas' acceptance of a proposed price increase would depend upon cost justification and that if the "cost could be substantially higher" NI-Gas "would agree to pay the increased price which is approved by the FPC." Ex. No. 33. There is no evidence that NI-Gas accepted this amendment, and Mr. Strickland stated that he did not recall receiving any reply. Tr. at 936-939. Certainly, it can be assumed that if the sellers of the gas had initially intended for the area rate clause to provide for entitlement to the highest price allowed by law without any limitation to cost-based rates, they would not have sought agreement to the price change.

In answer to the contention that the failure of Scarth's predecessors in interest to file for section 108 status on the Green Well indicates "a known lack of contract entitlement to NGPA Section 108 rates", Scarth cryptically

states that "the absence of a Section 108 filing can be explained in many ways, none of which support a known lack of contract entitlement to NGPA Section 108 rates." Scarth RB at 41-42. This statement and the supporting "for example" citation, provides no conclusive support for Scarth's counter-argument.

Conclusion

The course of performance evidence, as well as the evidence on the other items involving reliable and probative extrinsic evidence of the parties intent, is clearly insufficient to support Scarth's contention that the ARCs in issue entitle it to collect payment of section 108 NGPA ceiling prices. All the evidence, including the parties' assertion of mutual intent, contract language, oral and written extrinsic evidence, commercial trade usage, and evidence of course of performance, has been weighed in determining whether the area rate clauses in question provide the contractual authority for the payment and collection of the highest rates allowed by law. *Northern Natural Gas Co.*, 50 FERC ¶ 61,228, at p. 61,930 (1990); *Pennzoil II*, 789 F.2d at 1141; *Hunt Oil Co. v. FERC*, 853 F.2d 1226, 1237 (5th Cir. 1988).

In sum, such evidence not only does not suffice to overcome Scarth's admitted burden of demonstrating, by a preponderance of the evidence, the contracting parties' intent to pay and collect incentive-based NGPA section 108 rates, but rather supports the conclusion that the ARCs in question contemplated payment and collection of only cost-based prices.

In view of the above, NICOR's protest requesting the Commission to determine that the area rate clauses do not provide the necessary contractual authorization to entitle Scarth to collect incentive prices under the National Gas Policy Act is well taken and accordingly, is sustained.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Docket No. GP90-11-000

NICOR EXPLORATION COMPANY

ORDER AFFIRMING INITIAL DECISION
(Issued February 21, 1992)

Before Commissioners: Martin L. Allday, Chairman; Charles A. Trabandt, Elizabeth Anne Moler, Jerry J. Langdon and Branko Terzic.

Introduction

This proceeding involves the determination whether area rate clauses in certain gas sales contracts authorize the producer of the gas, Scarth Oil & Gas Co., (Scarth) to collect from the purchaser, NICOR Exploration Company (NICOR), the Natural Gas Policy Act 1978 (NGPA) section 108 stripper well price for gas produced from the Green #1-1 Well, located near Elk City, Oklahoma. The matter was set for hearing by the Chief Administrative Law Judge on November 1, 1990. On September 24, 1991, the presiding judge issued his Initial Decision holding that Scarth was not entitled under the terms of the contracts to collect the section 108 price. 56 FERC ¶ 63,023. Scarth filed a brief on exceptions to the Initial Decision and briefs opposing Scarth's exceptions were filed by NICOR and the Commission staff. Based on a careful review of the record and the briefs on and oppos-

ing exceptions, the Commission concludes that the judge's Initial Decision is amply supported in the record and is fully consistent with applicable Commission and judicial precedent. Accordingly, the Initial Decision is affirmed.

Background

The three contracts in question were executed in early 1970 between the GHK Company (GHK), Sun Petroleum Company (Sun) and Amerada Hess Corporation (Amerada Hess) as seller, and NICOR's predecessor, NI-Gas Supply, Inc., as purchaser (for convenience the name NICOR will be used throughout). NICOR in turn, was contracting on behalf of its corporate parent Northern Illinois Gas Company (NI-Gas), a large distribution company serving the Chicago area and supplied principally by Natural Gas Pipeline Company of America (NGPL). NICOR contracted to resell a portion (6/16) of the gas to NGPL and to have the remainder transported by NGPL to NI-Gas. The initial contract price under the contracts was 21 cents per Mcf with an escalation of one cent every four years. Following enactment of the NGPA in 1978, the applicable price was that prescribed for "flowing gas" under NGPA section 104. The record shows that NI-Gas provided additional nonprice inducements to the producers including loans to GHK and development commitments to Sun and Amerada Hess. (NICOR B.O.E. at 8-9).

The Sun and GHK area rate clauses are identical and provide as follows:

> If the Federal Power Commission, or any successor governmental authority having jurisdiction in the premises, shall at any time hereafter prescribe, for the area in which the contract is located, a higher, applicable, just and reasonable rate for the purchase of gas than the price herein provided to be paid, then the price to be paid by Buyer to Seller for gas delivered under the provisions of this Agreement shall be increased to equal such higher price effective

> as of the date such higher price is made applicable to the gas sold hereunder.

The Amerada Hess clause provides as follows:

> If the Federal Power Commission, or any successor governmental authority having jurisdiction over the sale of Gas hereunder, at any time thereafter prescribes or permits, by order following hearing, or by settlement, for the area in which the Gas Reserves are situated, an applicable higher price for the sale of gas than the price being paid hereunder at the time, then the price for gas delivered hereunder will be increased effective as of the date such higher price is prescribed or permitted to equal such higher price.

In 1988 and 1989 Scarth purchased the working interests in the Green well and associated acreage from the original contracting producers and others. On January 19, 1989, Scarth filed an application with the Oklahoma Corporation Commission (Oklahoma) to qualify the well as a stripper well under NGPA section 108 (average production of less than 60 Mcf per day). This determination was approved by Oklahoma and became final in September 1989. Scarth subsequently performed an enhanced recovery program on the well and on March 28, 1990 applied to have the well qualified as a section 108 (enhanced recovery) well. This determination was likewise approved and became final in December 1990. Based on the qualification of the Green well under section 108 and the existence of an area rate clause in each of the contracts, Scarth commenced billing NICOR in September 1989 for its purchases at the applicable section 108 rate. The current maximum lawful price under section 108 is $6.94 per MMBtu. NICOR declined to pay the section 108 rate and on July 11, 1990 filed a protest pursuant to 18 C.F.R. § 157.40(c)(1)(B) of the Commission's regulations to Scarth's claim of entitlement to stripper well rates. Scarth answered NICOR's protest on August 21,

1990, following which the case was set for hearing by the Chief Judge.

Framework for decision.

The framework for decision in this case is established by the Commission's Order No. 23 series,[1] the judicial decisions reviewing the Commission's interpretation and application of the Order No. 23 standards,[2] and relevant cases applying the standards in individual proceedings, notably Opinion No. 77, *Independent Oil and Gas Assn. of W. Va.*, 10 FERC ¶ 61,214 (1980). Under these guidelines the issue of whether an area rate clause authorizes the collection of all NGPA rates is to be determined primarily by reference to the mutual intent of the contracting parties at the time the contract was entered into. In cases such as this where the contracting parties are not in agreement as to intent, and the contract does not specifically include or exclude statutory rates, the Commission has stated it would consider "reliable and probative extrinsic evidence of the parties' intent." Opinion No. 77, 10 FERC at p. 61,397. The burden of demonstrating by a preponderance of the evidence the contracting parties' intent to pay and receive incentive rates is upon the party claiming the rate, in this case Scarth. (Order No. 23, *FERC Statutes and Regulations, Regulations Preambles 1977-1981* at p. 30,476 (1979); *Equitable Gas Co.*, 20 FERC ¶ 61,048, at p. 61,101 (1982). The Commission further stated in Opinion No. 77 that in

---

[1] Order No. 23, *FERC Statutes and Regulations, Regulations Preambles 1977-1981* ¶ 30,040, *reh'g* 7 FERC ¶ 61,152 (1979); Order No. 23-A, *FERC Statutes and Regulations, Regulations Preambles 1977-1981* ¶ 30,058, *reh'g*, 8 FERC ¶ 61,158 (1979); Order No. 23-B, *FERC Statutes and Regulations, Regulations Preambles 1977-1981* ¶ 30,065, *reh'g FERC Statutes and Regulations, Regulations Preambles 1977-1981* ¶ 30,073 (1979).

[2] *Pennzoil v. FERC*, 645 F.2d 369 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982); *Pennzoil Co. v. FERC*, 789 F.2d 1128 (5th Cir. 1986).

cases where reliable and probative extrinsic evidence is insufficient to permit ascertainment of the mutual intent of the parties, it would generally conclude that a contract containing an area rate clause did *not* authorize collection of all NGPA rates if the contract (1) refers to rates established by an administrative body, (2) the reference to administrative action is coupled with a reference to the Natural Gas Act or to the "just and reasonable" standard of the Act, *and* (3) the contract contains no language having the effect of "uncoupling" the link between agency action and the statutory standard. 10 FERC at p. 61,398.

The Initial Decision

The presiding judge held that Scarth had failed to sustain its burden of demonstrating that it was the mutual intent of the parties under the contract to authorize stripper well prices. The judge found the testimony of witnesses Daniel Parson, Robert Maurath, and Robert Hefner III to be persuasive as to the intent of NICOR at the time the contracts were executed. (I.D. at 7-8). Messrs. Parsons and Maurath were employed by and negotiated the contracts for NICOR on behalf of NI-Gas. Their testimony was that they informed each of the original producers that NICOR would agree to pay only cost-based rates (such as the then-prevailing area rates) and that the area rate clauses were intended to cover only rates approved in the future by the Federal Power Commission as "just and reasonable." (I.D. at 7). Witness Hefner, chairman of GHK, who was involved in negotiating the GHK-NICOR contract, supported the testimony of Messrs. Parson and Maurath. (I.D. at 8).

The judge found NICOR's testimony more persuasive than that of Messrs. J.W. Strickland of Sun, who negotiated the Sun-NICOR contract, and Donald W. Cook of Amerada Hess, who was involved in negotiating the Amerada Hess-NICOR contract. These witnesses were unable to recall the specific circumstances of the contract

negotiations and testified primarily concerning the general corporate policy of the original producers, which was that an area rate clause constituted a contractual basis for the highest prices allowed by law. (I.D. at 7). The judge declined to give weight to the testimony of witness Robert W. Scarth, president of Scarth Oil & Gas Co., that area rate clauses were standard and permitted collection of section 108 rates, since Mr. Scarth acquired the property in 1988-1989 and had no direct knowledge of the intent of the parties at the time the contracts were executed in 1970. (I.D. at 8).

The judge also considered the evidence dealing with trade and industry usage. (I.D. 9-10). Scarth's testimony on this issue was sponsored by its expert witness, Mr. Jack Earnest. Mr. Earnest testified that during the period 1960-1970, area rate clauses were standard in the industry and provided entitlement to the maximum rate permitted by law, including section 108 rates for wells which qualified under that section of the NGPA. (I.D. at 10). NICOR's testimony was sponsored by its expert witness Mr. Kenneth Williams. Mr. Williams testified that in the 1969-1970 period, producers and interstate pipelines knew that area rates were cost based, and that any producer or purchaser contracting in the late 1960's or early 1970's could assume that the prices under those contracts would remain cost based. (I.D. at 10). The judge found that NICOR's evidence was at least equally as persuasive as Scarth's and that in any event a finding that area rate clauses automatically authorized collection of all NGPA rates would be inconsistent with the Commission's conclusion in Order No. 23 that area rate clauses do not automatically permit escalation to NGPA ceiling prices. He therefore rejected Scarth's contention that the commercial context in which the clauses were executed supported the conclusion that both parties intended that the producers would be paid "the highest legal rate without limitation." Id.

Lastly, the judge considered Scarth's contention that the parties' mutual intent could be determined by reference to NICOR's performance under the contracts. (I.D. 11-13). Scarth argued that because NICOR had always paid the applicable NGPA rate subsequent to enactment of the NGPA, it could be inferred that NICOR had agreed to pay any NGPA rate including the section 108 rate. Scarth also noted that NICOR had agreed to pay Mobil Oil Company all applicable NGPA rates under a 1971 contract with Mobil for the purchase of reserves in East Cameron Block 81, Offshore Louisiana. The judge rejected these arguments, noting that while NICOR had in fact paid applicable NGPA rates under the Green contracts, those rates were the cost-based rates established under section 104 of the NGPA and that NICOR thus had never actually paid the producers a noncost-based rate. The judge further found that NICOR's agreement to pay incentive rates under the Mobil contract was irrelevant to determining NICOR's course of performance under the subject contracts. The judge also noted that none of the original producers filed for section 108 status despite the well's eligibility as early as 1986, and that NICOR had rejected the producers' request in 1975 to rework the well in exchange for a higher price. Accordingly, the judge rejected Scarth's course of performance arguments. He concluded that rather than supporting Scarth's claim the evidence actually tended to support the conclusion that the area rate clauses in question contemplated payment and collection only of cost-based rates. He accordingly sustained NICOR's protest.

On October 24, 1991, Scarth filed a brief excepting to virtually every finding made by the judge. According to Scarth, the principal error in the Initial Decision is the judge's reliance on the testimony of NICOR's witnesses as representing NICOR's actual *corporate* intent when the Green contracts were executed. Scarth argues that the evidence supports the conclusion that NICOR's actual corporate intent was that it interpreted all area rate

clauses to provide entitlement to the highest rate permitted by law, and that the only exception to this standard practice was its refusal to pay section 108 prices under the Green contracts. Briefs opposing Scarth's exceptions were filed by NICOR and the staff. We consider Scarth's exceptions seriatim.

Discussion of exceptions

1. Direct evidence of intent

Scarth argues that the judge erred in relying on the testimony of witnesses Parson, Maurath and Hefner in determining NICOR's intent. Scarth argues that the judge overlooked Mr. Parson's "conflicting admissions" on cross-examination and lack of memory as to "numerous" contemporaneous facts. Scarth also argues that Mr. Parson's testimony that NICOR intended to pay only cost-based rates is contradicted by certain contemporaneous statements Mr. Parsons made to the Illinois Commerce Commission to the effect that economic incentives were necessary to encourage producers to expand their exploration efforts in light of then-existing negative supply trends. (Scarth B.E. at 46-51). Similar criticisms are made of Mr. Maurath's testimony. Scarth argues that while Mr. Maurath appears clearly to remember that during the contract negotiations it was his (and NICOR's) firm intention to allow only for cost-based rates, he did not remember other circumstances involving the contracts, such as the producers' 1975 proposal to rework the Green well or the status of the then-pending Hugoton-Anadarko area rate proceeding before the FPC. Scarth also alleges that the witness failed to distinguish between "cost-based" and "cost-of-service" rates. (Scarth B.E. at 54). Scarth further argues that the presiding judge mischaracterized the testimony of witness Hefner in concluding that Mr. Hefner agreed that NICOR had made it clear to him during the contract negotiations that it would pay only a cost-based rate. According to Scarth, Mr. Hefner testified

only that he "suspected" that NICOR's intent concerning cost-based rates had been made clear to the producers.

The Commission observes preliminarily that the determination of intent is an issue of fact which turns largely on the credibility of the witnesses. In such cases the credibility findings of the presiding judge "are entitled to special weight and are not to be easily ignored." *Pennzoil Co. v. FERC*, 789 F.2d 1128, at 1135 (5th Cir. 1986). This policy has been recognized and adopted by this Commission. In *United Gas Pipe Line Co.*, 27 FERC ¶ 61,199, at p. 61,370 (1984), the Commission stated:

> In the instant case, the question is one of intent. In resolving such a question it is important to be present at the hearing to observe the demeanor of the witnesses and thus evaluate their credibility. Therefore we give great deference to the judge on the question of the weight of the evidence.

The Commission has reviewed the testimony of witnesses Parson, Maurath and Hefner with the above considerations in mind and finds that such testimony fully supports the judge's findings. The testimony of Messrs. Parson, Maurath and Hefner are highly relevant since these parties were directly involved in negotiating the subject contracts in 1970. These witnesses had a clear recollection of the central objectives of the negotiations even though, understandably, they could not remember every detail of discussions occurring over 20 years ago. Mr. Parson testified as follows—(Exh. 7 at 2):

> During the course of the negotiations with Sun, Amerada and GHK for the Green #1-1 gas, I described to their representatives the business of Northern Illinois Gas Company and emphasized that this gas was being purchased for Northern Illinois Gas Company. I further explained the regulatory and competitive situation facing Northern Illinois Gas Company as a local distribution company—its gas

> purchases could be judged for prudence by the Illinois Commerce Commission, with the possibility of not being permitted to recover excessive costs from customers. Also, to an unusual degree compared with other gas distribution companies, Northern Illinois Gas Company faced competition from low-cost coal. I emphasized that NI-Gas Supply, Inc. could only agree to pay cost-justified rates and that the area rate clauses would cover only such rates as were approved in the future as just and reasonable by the Federal Power Commission. (Ex. 7 at 2).

Likewise, Mr. Maurath testified that NICOR intended to agree to a price increase under the area rate clauses only "if the Federal Power Commission set a higher ceiling price based upon a higher cost of service or higher costs of production from the area." (Exh. 30 at 4-5). He testified that insistence by the producers would have been a "deal breaker" and that "if I had taken a contract to the NI-Gas Supply, Inc. board that provided for indefinite or non-cost price increases, I probably would have been tossed out of the room . . ." (TR at 484; Exh. 30 at 5).

The testimony of witnesses Parson and Maurath is corroborated by that of witness Hefner, who testified that "pricing under the contract was a major part of our negotiations, and I recall specifically discussing and negotiating the price terms with Mr. Maurath and Mr. Parson [who] were extremely conservative in their approach to price discussion." (Exh. 21 at 3-4). In discussing the contract area rate clauses, Mr. Hefner testified that "I cannot recall the exact words they used, but it was apparent to me from the way they handled the negotiations on behalf of NI-Gas and given the regulatory framework they operated under, that Maurath and Parson intended to protect NI-Gas on pricing to the full extent of the law." (Id. at 5-6). Mr. Hefner testified further that "I am certain that the testimony of Mr. Maurath and Mr. Parson

accurately states the intentions they expressed at the time we entered into the contract. I have absolutely no doubt that the direct testimony of Mr. Maurath and Mr. Parson reflects their exact intent at the time we negotiated the contract." (Id. at 7). At another point he testified that he "felt GHK was stuck with low area rates . . ." (Exh. 21).

The Commission finds this testimony to constitute reliable and probative evidence of NICOR's as well as GHK's intent at the time the contracts were negotiated. Scarth's attempt to discredit the testimony of Messrs. Parson and Maurath because of their alleged confusion concerning the difference between cost-based and cost-of-service rates is without merit. These witnesses testified that it was their understanding that the FPC's area rates were essentially cost based, and that the successor NGPA section 104 rates are likewise cost based as recognized by the judge. (I.D. at 12). Scarth's observation that the area rates and section 104 rates contain certain incentive elements and are therefore not strict "cost-of-service" rates is of no consequence. The Commission also finds no inconsistency between Mr. Parson's understanding of the effect of the area rate clause at issue and his testimony before Illinois Corporation Commission (the ICC) that existing regulatory policies should be modified to provide additional incentives for exploration. It is reasonable to assume that any new incentives for exploration would be applied to newly discovered reserves rather than imposed on existing contracts. In any event this argument is speculative and unpersuasive. It follows that Scarth's exceptions on the above issues must be denied.

2. NICOR's actions as evidence of intent

Scarth alleges that certain actions by NICOR are inconsistent with the understandings expressed by Messrs. Parson, Maurath and Hefner and reveal a different corporate intent. Scarth first observes that in the 1950's and

60's. NICOR was involved with numerous producers in joint venture projects to explore for and develop gas reserves. Mr. Maurath testified that he participated in the negotiation of some 200-300 contracts under which NICOR was one of the producer-sellers. (TR at 446-47). Mr. Maurath testified that NICOR relied on the operators of the particular properties to negotiate contracts with purchasers and that he and his supervisor reviewed the contracts after they had been negotiated. (TR at 447-50). Scarth argues that NICOR's position in this case is contrary to the understanding of NICOR's numerous producer co-owners, who believed area rate clauses entitled them to the highest rate permitted by law. Scarth also observes that NICOR's resale contract with NGPL incorporated an area rate clause and alleges that "NICOR has agreed in writing that the NGPL contract provides for all NGPA rates, [Ex. 34]." (Scarth B.E. at 53). Scarth further alleges that in the case of the Mobil contract (the only other contract under which NICOR is a purchaser), which contains an area rate clause, NICOR has agreed in writing that the clause "provides entitlement to all NGPA rates. [Ex. 18]." *Id.* Scarth argues that the above instances demonstrate that NICOR's actual corporate policy was to treat area rate clauses as permitting the highest lawful rate.

Upon review, the Commission concludes that Scarth's arguments are without merit. This record does not contain evidence concerning the views of NICOR's co-interest producers as to the effect of area rate clauses in the numerous gas sales contracts referenced by Mr. Maurath. Assuming *arguendo*, however, that the producers' views were as suggested by Scarth, we find no reasonable or proper basis to impute those views to NICOR, as purchaser under the Green contracts, when the evidence demonstrates that NICOR's views were in fact directly to the contrary. This is particularly true in view of the fact that the sales contracts were not negotiated by NICOR.

Scarth's reference to the NGPL resale contract is even less persuasive. In exhibit 34, which is the alleged agreement by which NGPL agreed to pay all NGPA prices,[3] NGPL points out that this Commission had not finally resolved whether payment of the highest NGPA ceiling prices is authorized by area rate clauses and consequently agreed to their payment provided "you (NICOR) agree to refund to Natural any and all sums determined by final non-appealable order of the Federal Energy Regulatory Commission . . . to be in excess of the contractual rate . . ." In any event the contract in question was not a normal resale contract but provided merely that NICOR would recover from NGPL what NICOR actually paid to the producers under the Green contracts. (TR at 468). We fail to see how this arrangement or the terms of the resale contract support Scarth's position.

The Commission is likewise not persuaded by Scarth's arguments based on NICOR's performance under the 1971 Mobil contract. The area rate clause in the Mobil contract provided that Mobil would be entitled to increase its contract rate, "If the Federal Power Commission, or any successor governmental authority having jurisdiction in the premises, shall at any time hereafter prescribe or permit, by *policy* or *rule* or by order following hearings, or by settlement, for the area in which Seller's properties are located, a higher applicable just and reasonable area ceiling rate . . ." (Exh. 17 at 27, emphasis added). This clause is broader than those in the Green contracts by virtue of its reference to the determination of rates by "policy or rule." In Opinion No. 77, the Commission, in considering the interpretation of an area rate clause incorporating the word "policy," stated that "we are unable to accept the conclusion of the Presiding Judge that 'issuance of policy' cannot constitute a reference to Congressional action. Indeed we find that conclusion rather

---

[3] This agreement is in the form of a letter from NGPL to NICOR dated May 16, 1979, and countersigned by NICOR.

strained. We believe that the phrase is sufficiently broad to encompass a legislative enactment . . ." (10 FERC at p. 61,403). The Commission went on to state that the reference to policy and the omission of any reference to the Natural Gas Act or the just and reasonable standard pointed toward an intent to allow prices to rise to the highest legally permissible rates. The Mobil clause is a hybrid in that it references both "policy" and "just and reasonable" rates and therefore does not fit perfectly the contract considered in Opinion No. 77. Nevertheless, we believe the difference between the Green and Mobil clauses tends to show that NICOR would have been more willing to accept the full range of NGPA rates under the Mobil contract than under the more narrowly worded Green contracts. This inference is consistent with the 1979 agreement between Mobil and NICOR (Exh. 18) which provided that the parties agreed that Mobil would be entitled to all applicable NGPA prices.

The Commission does not agree with the judge that the circumstances surrounding the Mobil contract are irrelevant to the issue of intent under the Green contracts. The Green and Mobil contracts apparently represent the only wellhead purchases made by NICOR, and it seems clear that NICOR's agreement to pay all NGPA rates under the Mobil contract casts at least some degree of doubt on its argument that it did not intend to pay similar rates to the Green producers. The greater the similarity between the contracts, the greater the doubt. In this instance we believe that the area rate clause in the Mobil contract is sufficiently broad that NICOR's agreement to pay Mobil all NGPA rates cannot be viewed as inconsistent with its unwillingness to pay the same rates under the Green contract. All parties appear to agree that the March 26, 1979 letter of understanding between Mobil and NICOR constitutes an amendment of the original 1971 contract. (NICOR B.O.E. at 50). NICOR contends that it originally did not intend to pay Mobil other than cost-based rates and did not agree until

it countersigned the March 26 letter. The Commission does not believe it is necessary to determine whether the March 26 letter is, in fact, an amendment of the Mobil contract, since we have found that even if it were not an amendment but only a confirmation of original intent, the difference between the terms of the original contracts is sufficient to explain NICOR's differing performance under the respective contracts.

3. Trade usage

Scarth argues that NICOR should be deemed to have agreed to pay all NGPA rates under the Green contract area rate clauses based on principles of trade usage. Scarth argues that under Oklahoma law, as a contracting party NICOR is assumed to have known of existing trade usage and is bound by that usage whether or not it knew of or agreed with that usage, citing *United States v. Stanolind Crude Oil Purchasing Co.*, 113 F.2d 194 (10th Cir. 1940) and other cases. (Scarth B.E. at 62). Scarth argues that to the extent NICOR disagreed with the trade usage it had an affirmative obligation to notify the producers when the Green contracts were negotiated, and that since no such notice was given, the contracts must be deemed to have been negotiated on the basis of the commonly accepted interpretation of area rate clauses (Scarth B.E. at 63). Scarth argues that the testimony of its witness Jack Earnest demonstrates that in the late 1960's through enactment of the NGPA, there existed a trade usage in the interstate natural gas market that an area rate clause authorized of the highest lawful rate irrespective of language variations. (Scarth B.E. at 66). Scarth relies on data provided by Mr. Earnest showing that the "overwhelming majority" of pipeline purchasers agreed to pay all NGPA prices under area rate clauses. Scarth argues that Mr. Williams' testimony that industry trade usage was that area rate clauses provided only for cost-based rates is erroneous and that the judge's reliance on Mr. Williams' testimony constitutes substantial error.

The Commission finds no merit in this exception. We agree with NICOR and the Commission staff that for a variety of reasons trade usage fails to support Scarth's claim of entitlement to section 108 rates. NICOR and the staff point out that the argument that trade usage automatically establishes entitlement to NGPA incentive rates is flatly inconsistent with the Commission's specific holding in prior cases such as, for example, *Equitable Gas Company*, 20 FERC ¶ 61,048 (1982), in which the Commission stated that it "has never found that the usage of trade in the natural gas industry is that all area rate clauses would authorize the highest regulated price. Indeed, as noted in Order No. 23, the Commission found just the opposite." (20 FERC at p. 61,101). The Commission went on to state that "there is no universal usage of trade with which to construe these contracts and [the Commission] established procedures to interpret each clause on a case by case basis." *Id.* We agree with NICOR that Mr. Earnest's testimony is an impermissible attack on Order No. 23. *See Associated Gas Distributors v. FERC*, 810 F.2d 226 (D.C. Cir. 1989). We also agree with NICOR and the staff that Mr. Earnest's testimony is unreliable because it reflects trade usage only for interstate pipelines and includes no data for LDCs. Scarth argues that the Green contracts do not involve a sale to an LDC since NICOR is not an LDC. This argument is not credible. NICOR was created solely to avoid having NI-Gas subject to federal regulation. All of the contracting parties were aware that NI-Gas was the actual purchaser. In light of the foregoing, Scarth's trade usage exception is denied.

4. Commercial context

Scarth argues that the judge ignored evidence demonstrating the commercial context surrounding the Green contract negotiations. According to Scarth that commercial context includes NICOR's "desperate" need for the Green gas, competition for the Green gas, and the

types of proposals the producers had received from NICOR's competitors. (Scarth B.E. at 74). Scarth states that two potential interstate purchasers presented actual proposals to the Green producers—NGPL and Panhandle Eastern Pipe Line Company, that both proposals contained area rate clauses similar to those in the Green contracts, and that as demonstrated by their actions after enactment of the NGPA, both NGPL and Panhandle intended this type of clause to provide entitlement to all NGPA rates. (Scarth B.E. at 75-76).

Scarth's exceptions on this issue are frivolous. The NGPL and Panhandle offers are not in the record and there is no information concerning any discussions the parties had as to consideration offered or demanded. It would serve no useful purpose to speculate on these matters. This is a wholly speculative question and we agree with the judge's observation that this line of inquiry is basically irrelevant. (TR at 127).

5. Regulatory context

Scarth argues that the FPC's area rates were not strictly cost-of-service rates but included some incentive features, and that NICOR is therefore in error in arguing that it intended to pay only "utility-type" rates and that non-cost elements were not anticipated. Scarth further argues that it was NICOR's obligation in negotiating the Green contracts to request a modification of the standard area rate clause language to reflect its more restrictive interpretation, and that it did not do so because "it knew the Green producers would not agree." (Scarth B.E. at 81).

These arguments are unpersuasive. NICOR never objected to paying area rates or the successor section 104 rates even to the extent they contain non-cost factors. NICOR has stated that it intended to pay rates which were cost based and that it perceived the FPC area rates and the section 104 rates to be cost based. NICOR is

correct in this regard. The area rates and section 104 rates are essentially cost based. The fact that they may include particular incentive elements is of no consequence. Scarth is essentially arguing that because NICOR agreed to pay area rates it thereby automatically agreed to pay NGPA section 108 rates. This does not follow. Nor do we agree that NICOR was obligated in 1970 to incorporate more restrictive language in the contract and having failed to do so is now precluded from demonstrating its intent. The Commission knows of no basis and none has been cited which would justify retroactively imposing this type of disqualifying requirement. The contract must be accepted as written and interpreted consistent with the guidelines of Opinion No. 77.

6. Course of performance

Scarth again notes that in 1970, FPC area rates included both cost and non-cost factors and that NICOR actually paid such area rates and subsequently paid NGPA section 104 rates for the Green production. Scarth argues that this course of performance demonstrates that NICOR's actual corporate intent was to pay incentive rates, including section 108 rates. This argument must be rejected for the same reasons set forth in the preceding discussion. Agreement to pay section 108 rates simply cannot be inferred from actual payments of area rates or section 104 rates.

Scarth also excepts to the presiding judge's finding that NICOR's position is supported by the producers' attempt in 1974-75 to negotiate an increase in price under the FPC's special relief regulations, in return for performing a workover of the well. Mr. Maurath responded that NICOR was "not willing to raise the price of gas based on the proposed workover, but that if the cost of the workover was substantial NICOR would not oppose a request by the producers to the FPC for approval of a higher rate and would pay the higher rate if approved

by the FPC." (Exh. 33). The judge held that the producers' renegotiation proposal belied their representations that they were allowed under their contracts to the "highest price allowed by law." (I.D. at 12). We agree with Scarth that the renegotiation proposal is in no way evidence that the producers believed their area rate clauses did not allow incentive rates. Under no circumstances would an area rate clause, whether narrow or broad, entitle a producer to a special relief rate since specific Commission approval would be required. Therefore Scarth's exception on this issue is granted. However, we believe that NICOR's *response* to the renegotiation supports its contention that it intended to pay only cost-based rates. We also note that on March 7, 1980, Sun requested NICOR to amend its contract to provide for NGPA pricing. (Exh. 111). NICOR declined. We believe this is evidence, if not of Sun's view of its area rate clause, at least of NICOR's view of the clause.

Decision

The presiding judge found that "in the instant proceeding, there is no reliable and probative evidence sufficient to ascertain the mutual intent of the parties and the evidence of such intent might be deemed inconclusive." (I.D. at 5). The judge accordingly applied the interpretive guidelines of Opinion No. 77, and concluded that under those guidelines the contracts must be deemed to authorize cost-based rates only. (I.D. at 6). The judge therefore sustain NICOR's protest. Scarth argues that the record mandates the conclusion that the parties mutual intent was to permit incentive pricing. Assuming *arguendo*, however, that the Opinion No. 77 standards are to be applied, Scarth argues that the contracts as so interpreted authorize incentive rates. As previously noted, Opinion No. 77 provides that the Commission will generally find authority to collect NGPA incentive rates lacking in cases where the contract (1) refers to rates established by an administrative body, (2) couples reference

to administrative action with a reference to the Natural Gas Act or to the just and reasonable standard of the Act, and (3) there is no language uncoupling items (1) and (2). In cases where these disqualifying terms are *not* all present, the Commission stated it would "generally find that an area rate or national rate clause authorizes NGPA rates." (10 FERC at p. 61,389). According to Scarth each of the three Green contracts should be judged by reference to the area rate clause in the Amerada Hess contract, (Scarth B.E. at 92-93), and since that contract does not contain disqualifying terms (1) and (2) Scarth must prevail. NICOR and the staff reject the argument that each of the contracts should be judged by reference to the Amerada Hess clause, and they argue that under the Opinion No. 77 guidelines the contracts do not permit NGPA incentive prices.

Upon review of the evidence, the Initial Decision, and the arguments on and opposing exceptions, the Commission concludes that the judge's ultimate determination that the contracts do not authorize incentive rates is correct and is supported by the record, although we do not fully agree with the judge's reasoning. We thus herewith set forth the basis for our decision. First, we find that the testimony of Messrs. Parson, Maurath and Hefner constitute reliable and probative extrinsic evidence demonstrating that the mutual intent of the contracting parties under the GHK contract was that only cost-based rates were intended. We agree with the judge that under the two remaining contracts, mutual intent was not established. NICOR envisioned only cost-based rates, while Sun and Amerada Hess appear to have contemplated the highest rates permitted by law. Accordingly, the issue as to the Sun and Amerada Hess contracts must be determined according to the contract language in light of the interpretive guidelines of Opinion No. 77. Under those guidelines it is clear that the Sun contract did not authorize the collection of incentive rates. The contract falls squarely with the guidelines since it references the "Fed-

eral Power Commission, or any successor governmental authority," couples the reference to administrative action with "a higher, applicable, just and reasonable area rate," and contains no uncoupling language. Accordingly we hold that Scarth is not entitled to collect the section 108 rate under the Sun contract.

The Amerada Hess contract is more difficult. While this contract references the "Federal Power Commission, or any successor governmental authority having jurisdiction," and therefore meets guideline (1), it does not contain any specific reference to the Natural Gas Act or to the "just and reasonable" standard of the Act. Since this element is missing, Scarth argues that the contract must be interpreted as permitting NGPA incentive rates. NICOR and the staff disagree. They argue that the Amerada Hess clause, in referring to a price prescribed by the FPC (or any successor governmental authority) "by order following hearing, or by settlement" is equivalent to the term "just and reasonable" and that the second standard of Opinion No. 77 is therefore met. While the decision on this issue is not easy or clear-cut, we believe, on balance, that NICOR and the staff have the better argument. We believe that the most logical, most obvious, most natural and most reasonable interpretation of the cited language is that it refers to just and reasonable rates approved following an administrative hearing, or by settlement, in accordance with the requirements of the Natural Gas Act. The Commission's only authority for holding an administrative hearing covering the contract rate would be the Natural Gas Act. Under section 4(a) of the NGA, the Commission is precluded from approving any rate other than one that is just and reasonable, either through formal procedures or by settlement. It follows that references to the NGA and to the just and reasonable standard are implicit in the Amerada Hess clause by virtue of the inclusion of the requirement for the approval of a rate following a hearing, or by settlement. This conclusion is consistent with the Commis-

sion's prior decision in *Oklahoma Natural Gas Gathering Co.*, 23 FERC ¶ 61,654 (1983), in which the Commission interpreted an area rate clause, which provided for a rate "prescribed or approved by settlement in a proceeding instituted in accordance with the NGA . . . ," as meeting guideline (2) of the Opinion No. 77 test. We reach the same conclusion as to the Amerada Hess clause here. Based on the foregoing considerations, the Initial Decision is affirmed.

The Commission orders:

The Initial Decision issued herein on September 24, 1991 is affirmed, and NICOR's protest is sustained.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Docket No. GP90-11-001

NICOR EXPLORATION COMPANY

ORDER GRANTING REHEARING IN PART

(Issued April 7, 1993)

Before Commissioners: Elizabeth Anne Moler, Chair; Jerry J. Langdon, Martin L. Allday, and Branko Terzic.

On March 20, 1992, Robert W. Scarth (Scarth) (successor to Scarth Oil & Gas Co.) requested rehearing of an order [1] in the captioned proceeding issued February 21, 1992, affirming an Initial Decision [2] issued September 24, 1991. The February 21, 1992 order held that Scarth was not entitled, as a successor under any of three gas sales contracts entered into in January 1970, to collect Natural Gas Policy Act of 1978 [3] (NGPA) section 108 stripper well maximum lawful prices (MLP) for gas produced from a well, known as the Green No. 1-1 Well, located near Elk City, Oklahoma. For the reasons set forth below, we grant rehearing to the extent that we find that the subject natural gas sales contracts authorized the collection of the NGPA section 108 maximum lawful price.

---

[1] 58 FERC ¶ 61,203.

[2] 56 FERC ¶ 63,023.

[3] 15 U.S.C. §§ 3301-3432 (1988).

Background

The three contracts at issue each contain an area rate clause. The gas sold under each of these contracts was purchased by NICOR Exploration Company (NICOR) for its parent, Northern Illinois Gas Company (NI-Gas), a large local distribution company serving the Chicago area and supplied by Natural Gas Pipeline Company of America (Natural).[4] Scarth is successor in interest to the original sellers under the three contracts, GHK Company (GHK), Sun Petroleum Company (Sun), and Amerada Hess Corporation (Amerada Hess).

The three contracts were entered into in January 1970, when the Commisison's predecessor, the Federal Power Commisison (FPC), established rates for natural gas production pursuant to the just and reasonable standard in the Natural Gas Act. There is no dispute that the area rate clauses here at issue authorized collection of the highest lawful price established by the Federal Power Commission. Nor is there any dispute that they authorized collection of "cost-based" ceiling rates subsequently prescribed by Congress in section 104 of the NGPA. The issue, here, is whether they also authorized collection of the higher incentive stripper well ceiling rate prescribed by Congress in section 108 of the NGPA.

The Commission's rules provide that an area rate clause may operate to authorize the collection of all NGPA ceiling rates to the extent consistent with the parties' intent under their contract.[5] If the purchaser protests the seller's assertion of contractual authorization, as in the instant case, procedures established in Order No. 23, *et al.*,[6]

---

[4] GHK, Sun, and Amerada Hess each owned a 31.25 percent working interest in the production from the Green Well. NICOR owned the remaining 6.25 percent working interest in the production.

[5] 18 C.F.R. § 270.205(a)(2) (1992).

[6] Order No. 23, *FERC Statutes and Regulations, Regulations Preambles 1977-1981* ¶ 30,040, *reh'g* 7 FERC ¶ 61,152 (1979);

and Opinion No. 77[7] come into play. There is a two-step process. The first step is to attempt to ascertain, with the aid of extrinsic evidence, whether the parties to the contract had a mutual intent with respect to the operation of the area rate clause and, if so, what that mutual intent was. If there is no reliable and probative extrinsic evidence submitted by the parties or the evidence is inconclusive to permit ascertainment of a *mutual* intent of the parties, the Commission will then decide the matter solely by reviewing the express terms of the area rate clause pursuant to interpretative standards established in Opinion No. 77.

At the hearing in the proceeding both parties presented the testimony of witnesses who were involved in the actual negotiation and execution of the subject contracts, along with evidence of commercial and regulatory context, course of performance, course of conduct, and trade usage. Scarth presented testimony and other evidence to support its position that the mutual intent of the parties to all three of the Green contracts was to collect the highest price allowed by law, whereas NICOR countered with testimony and evidence to show that NICOR only intended to pay cost-based rates, and not incentive rates. The Initial Decision held that there is no reliable and probative evidence sufficient to ascertain the mutual intent of the parties and that the evidence of intent might be deemed inconclusive.[8] Accordingly, the ALJ applied

---

Order No. 23-A, *FERC Statutes and Regulations, Regulations Preambles 1977-1981* ¶ 30,058, *reh'g*, 8 FERC ¶ 61,158 (1979); Order No. 23-B, *FERC Statutes and Regulations, Regulations Preambles 1977-1981* ¶ 30,065, *reh'g FERC Statutes and Regulations, Regulations Preambles 1977-1981* ¶ 30,073 (1979). *See also Pennzoil v. FERC*, 645 F.2d 369 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982); *Pennzoil Co. v. FERC*, 789 F.2d 1128 (5th Cir. 1986).

[7] *Independent Oil and Gas Assn. of W. Va.*, 10 FERC ¶ 61,214 (1980).

[8] 56 FERC ¶ 63,023, at p. 65,090.

the Opinion No. 77 interpretative standards to the language of the area rate clauses in each of the three contracts and found that, under such standards, the contracts only authorized cost-based NGPA ceiling rates, such as section 104 rates, and not incentive rates, such as the section 108 rate sought by Scarth.

In the February 21, 1992 order, the Commission affirmed the holding of the Initial Decision that mutual intent under the Amerada Hess and Sun contracts was not established. However, the order reversed the same holding of the Initial Decision regarding the GHK contract, and found that the record did, in fact, establish a mutual intent under that contract to allow only cost-based (not incentive) rates. In applying the Opinion No. 77 interpretative standards to the Sun and Amerada Hess area rate clauses the order agreed with the Initial Decision that those clauses also only authorized cost-based rates and did not cover incentive rates under such standards. Accordingly, the February 21, 1992 order held that Scarth lacked contractual authority to collect the NGPA section 108 rate under any of the three subject contracts.

On rehearing, Scarth urges the Commission to reverse its rulings and, instead, rule that a preponderance of the evidence shows the mutual intent of the parties to allow incentive rates under all three contracts, and also that the Opinion No. 77 interpretative standards require a finding that incentive rates are covered by the contracts. As we discuss in detail below, we grant rehearing to the extent that we find that evidence of mutual intent under all three contracts is inconclusive and that, based on application of the Opinion No. 77 interpretive standards, all three area rate clauses authorized the collection of NGPA incentive maximum lawful rates, including the section 108 rate.

Discussion

A. *Extrinsic Evidence of Mutual Intent*

1. Testimony on the Intent of the Parties in 1970

In the February 21, 1992 order, the Commission found that the testimony of NICOR's witnesses Parson and Maurath, who negotiated the Green contracts for NICOR, constituted reliable and probative evidence of NICOR's intent in 1970 only to authorize the collection of "cost-based" ceiling rates, and not "incentive" ceiling rates such as the section 108 MLP, under any of the three contracts. The Commission also found that the prepared direct testimony of the GHK's witness Hefner, Chairman of GHK who negotiated the GHK contract, corroborated the prepared direct testimony of NICOR's witnesses in the case of GHK. On this basis, the Commission found that, in the case of the GHK contract, the evidence showed that NICOR's and GHK's *mutual* intent at the time the contract was executed in January of 1970 was that the area rate clause of the GHK contract did not authorize section 108 rates. Accordingly, the Commission reversed the Initial Decision on that issue.

Scarth argues that this finding regarding witness Hefner is erroneous and contrary to the record. In support, Scarth cites various testimony of witness Hefner on cross-examination that it was the intent of GHK to obtain the highest price permitted by law,[9] and that, to the extent NICOR intended the GHK area rate clause to be limited to less than that, GHK's intent was "materially different" from NICOR's.

Upon further consideration, we have concluded that it was error to rely solely on the prepared direct testimony of the GHK witness Hefner to find a mutual intent with NICOR under their contract in 1970 to not allow incentive rates, such as section 108 rates. The prepared direct testimony of GHK's witness Hefner is inconclusive, and

---

[9] Scarth rehearing request, pp. 32-33; 65-66.

his testimony on cross-examination reveals that GHK intended that the area rate clause of their contract would authorize the highest rate allowed by law. All that Hefner's prepared direct testimony confirmed was what the NICOR witnesses stated in their own prepared direct testimony: when they executed the GHK contract in 1970, neither party to that contract anticipated anything other than the status quo of area rates set by the Federal Power Commission (FPC) on a cost basis.[10] Where neither party to the contract anticipated specific later changed circumstances, it cannot be inferred that they had a *mutual intent* beneficial only to the purchaser to accommodate some changes in circumstances that occur later, (the passage of the Congressionally-set NGPA "cost-based" section 104 rates) but not other changes (Congressionally-set NGPA incentive section 108 rates). It was an improper extrapolation of Hefner's prepared testimony to read it as an "endorsement" of the concept that the area rate clause of the GHK contract could not allow incentive NGPA section 108 rates.

To the contrary, and completely inconsistent with the NICOR witnesses' position, Mr. Hefner clarified under cross-examination that he intended back in 1970 on always getting the "highest rate allowed by law" (Tr. 397). The following cross-examination of witness Hefner makes his intent abundantly clear:

> Q When you negotiated the contract on the Green Well, were you seeking to get the highest rate allowed by law?
>
> A Yes.

---

[10] Witness Hefner's prepared direct testimony stated: "I have absolutely no doubt that the *direct testimony* of Mr. Maurath and Mr. Parson reflects their exact intent at the time we negotiated the contract." (Exh. 21 at p. 7) (Emphasis added).

> Q Did you ever intend under the area rate clause to limit the rate you could collect to a rate less than the maximum the law would allow?
>
> A No, I don't believe we had any intent to do that.

Thus, the GHK witness placed no limit on how high such a rate might be, and no restriction on the nuances of how such a rate is set.[11] Consistent with his stated intent, GHK's witness Hefner testified (at Tr. 442) to the effect that he did *not* have a mutual intent with Nicor's witnesses Maurath and Parson as follows:

> Q Is the stated intent by Mr. Maurath and Mr. Parson in their testimony in this proceeding the same intent that GHK had in executing the area rate clause in the Green contract?
>
> A No. I would say it was materially different.

Finally, we grant rehearing to the extent we find that the record does not reflect, by a preponderance of reliable and probative evidence, that the NICOR negotiators made clear, to their counterparts on the other side of the negotiating table, NICOR's alleged intent at the time of the negotiations only to pay cost-based and not incentive ceiling rates under the area rate clause. In the February 21, 1992 order the Commission relied on the prepared rebuttal testimony of NICOR's witness Parsons that he had informed GHK and the other producers during the negotiations that NICOR only would agree to pay cost-based rates.[12] However, based on the cross-examination of its witnesses, NICOR conceded that there is no evidence that the matter of a "cost-based" limitation on the operation of the area rate clauses ever was expressed during the negotiations.[13] Indeed, the record

---

[11] *See, e.g.*, Tr. 390 and Tr. 398.

[12] 58 FERC ¶ 61,203, at pp. 61,632-61,633 (citing exhibit No. 7 at p. 2).

[13] NICOR Brief Opposing Exceptions at pp. 32-33; *See also* Tr. 396-397.

reflects that the matter of how the area rate clause would operate was not even the subject of the negotiations, as opposed to the level of the base rate per Mcf being offered (21 cents per Mcf).[14] Given the direct reliable and probative testimonial evidence supporting GHK's intent to always receive the highest lawful rate and NICOR's failure to state during the negotiations that it would not pay incentive ceiling rates under the GHK area rate clause, the evidence is inconclusive and, at best, there was no meeting of the minds when the GHK contract was executed (and, therefore, no mutual intent) on what would happen if such incentive ceiling rates were prescribed. Accordingly, we grant rehearing to that extent.

However, on rehearing, Scarth asks the Commission to go further and find that a preponderance of the evidence

---

[14] NICOR's witness Maurath reflects this lack of focus on the area rate clause (Tr. 455):

> Q As to the area rate clause was a lot of time spent on negotiating the area rate clause in these contracts?
>
> A No.
>
> Q Why not?
>
> A It was an area rate clause. Everybody knows what an area rate clause means. Area rates are area rates.

See also Hefner's testimony at Tr. 401. It is important to recall that the FPC's Hugoton-Anadarko Area Rate Proceeding (Docket No. AR64-1, *et al.*) covering the area in which the Green Well was located, was pending at the time of the negotiations and Opinion No. 586, 44 FPC 761, establishing the area rate did not issue until September 18, 1970. (Exhibit No. 49 at p. 5.) Thus, at the time of the negotiations, there were no specific FPC-established ceiling rates for the Green Well production and the parties were free to establish their own base rates, provided they were "in line" with other contract rates in the area of the sale. *See Atlantic Refining Co. v. Public Utility Commission of New York*, 360 U.S. 378 (1959) (*CATCO*). It is significant that the 21 cent base rate agreed on for the Green production was such an in-line price that was not based on a cost analysis of the Green production and exceeded the proposed rates found just and reasonable by the Administrative Law Judge in the pending area rate proceeding. *See* 44 FPC at p. 768.

shows that NICOR intended to pay incentive rates under all three of the Green contracts. Scarth argues that the Commission erred in finding NICOR's witnesses credible. Scarth asserts that (1) by asserting that that there can be no other interpretation than theirs, the NICOR witnesses demonstrated they are out-of-touch with the rest of the industry and Order No. 23, (2) the record reflects that NICOR's negotiators were given no corporate guidance in 1970 and no internal documents or correspondence mentioning the phrase "cost-based," and, accordingly, the NICOR witnesses' 1991 testimony of the corporation's intent in 1970 is disingenuous; and, (3) the testimony of NICOR's witnesses was refuted by the actions of the corporation in 1970 and later in seeking price incentives for producers.

Scarth further argues that the Commission erred in rejecting the commercial and regulatory evidence presented. Scarth argues that NICOR was desperate for gas at the time of execution of the subject contracts and would gladly have agreed to the highest rates in area rate clauses. Scarth alleges that Panhandle Eastern Pipe Line Company (Panhandle) and Natural, as competitors for such gas, offered or would have offered the highest area rate clause prices for the Green gas. Relying on rejected testimony of a retired Panhandle employee Newlin that Panhandle would have offered the highest area rate prices, Scarth argues that NICOR would have offered the same deal to meet its competition for these gas supplies.

Finally, Scarth objects that although the February 21, 1992 order indicates that the Commission undertook an independent review of the record of this case, the order misstates the record, ignores critical elements in the evidence, and contains other errors of fact. As an example of an error of fact it cites a statement in the order [15] that it would be unreasonable to impute to NICOR the con-

[15] 58 FERC p. 61,634.

trary views of producers that were parties to the 200-300 other gas sales contracts in the 1950's and 60's to which NICOR was a party as a producer-seller because NICOR did not negotiate any of the sales contracts. Scarth observes that NICOR's witness Maurath stated that he participated in the negotiaton of approximately 300 contracts for NICOR and personally negotiated many of those after the mid-1960s (Tr. 446-8).

With the exception of NICOR's contradictory testimony on the issue of whether NICOR expressed any cost-based limitation during the negotiations, we find that Scarth has raised nothing new on rehearing to warrant overturning the Commission's decision to affirm the ALJ's finding that the testimonies of the NICOR witnesses Parson and Maurath were credible. Accordingly, we deny rehearing on this issue. However, this does not mean that we find this after-the-fact testimony to be conclusive on the issue of what NICOR would have done if the matter of what was apparently unthinkable to NICOR's witnesses back in 1969-70, a change to *lawful* incentive-based ceiling rates, was raised during the negotiations. NICOR's witnesses never testified that they actually had any intent, positive or negative, at that time as to that unforeseen circumstance. All that the record reflects is that NICOR's witnesses thought that paying a non-cost-based rate would always violate the law in the regulatory context that existed at that time.[10] Having reviewed the totality of the evidence, we think that the evidence is merely inconclusive as to NICOR's original intent on that issue in the changed circumstance of NGPA pricing; not that a pre-

---

[10] *See, e.g.*, Tr. 269. (Parson: "If the Federal Power Commission had issued a decision . . . which resulted in the recovery of costs that exceeded actually incurred costs . . . I would personally have disagreed with its [the FPC's decision] validity.") *See also* NICOR witness Maurath's Prepared Direct Testimony, exhibit No. 30 at p. 5 ("We did not anticipate natural gas wellhead pricing that was based on anything other than an analysis of the cost of service").

ponderance of the evidence shows that NICOR intended to pay incentive rates as Scarth argues.

Turning to certain of Scarth's specific arguments that have not already been adequately addressed, we reject Scarth's contention that it was error to decline to consider the testimony of an employee of another pipeline, Panhandle, as to that other pipeline's intent in negotiating for production from the Green well, particularly in light of the fact that that witness states in his testimony that he was not involved in the negotiations. Scarth's arguments rely on mere post hoc speculation that NICOR would have had the same intent as another pipeline. Further, nothing Scarth urges on rehearing leads us to conclude it was error not to impute alleged views of co-interest producers under other contracts to NICOR's personnel when they negotiated for the purchase of gas under the Green contracts. Indeed, as a producer-seller under those other contracts, *i.e.*, a working interest owner in the production from other wells, NICOR's interest would have been different than as purchaser under the Green contracts. Thus, the evidence of the intent of the co-interest producers, or of NICOR itself, under these other contracts is not reliable and probative of NICOR's intent in 1970 as a purchaser under the Green contracts and cannot be given more than minimal weight in the determination of the credibility of the NICOR witnesses.

2. Course of conduct and performance

In the February 21, 1992 order, the Commission rejected Scarth's argument that NICOR's course of conduct under other contracts was inconsistent with the testimony of its witnesses. On rehearing, Scarth observes that, in reviewing a Commission decision under the Order No. 23 and Opinion No. 77 standards, the court in *South Dakota Public Utilities Commission v. FERC*, 934 F.2d 346, 350 (D.C. Cir. 1991), stated that a gap in the evidence of the parties' original intent under the contract can be filled

with reference to the parties' course of conduct. Scarth argues on rehearing that we should find a *mutual* intent of the parties to all three contracts to accept NGPA incentive rates based on the parties' subsequent course of conduct.

Scarth reiterates its argument that NICOR confirmed an unlimited intent with respect to the Green contract area rate clauses because of its actions under two other contracts containing similar or identical area rate clauses. NICOR executed a contract on January 5, 1970, to sell its 1/15th interest in gas produced from the Green Well to Natural Gas Pipeline Corporation (Natural).[17] On November 4, 1971, NICOR executed a contract under which NICOR purchased gas from Mobil Oil Co. (Mobil) from offshore Louisiana.[18]

Regarding the contract with Natural, Scarth asserts that the Commission erred in finding unpersuasive Scarth's reliance on a May 16, 1979 letter agreement between Natural and NICOR under which Natural agreed to pay all NGPA rates under the January 5, 1970 contract. The Commission found that the Natural contract was not a normal resale contract in that it merely provided that NICOR would recover from Natural what NICOR paid the producers under the other Green contracts. Scarth asserts that the 1970 contract was, in fact, a normal gas sale contract and had its own area rate clause. The Commission also observed that the 1979 Natural letter agreement had a refund provision in case the Commission or a court later found that the area rate clause did not authorize NGPA rates. Scarth asserts that the refund clause was common at that time.

---

[17] (Ex. 16). The area rate clause in the contract with Natural was identical to the area rate clause in the Sun and GHK contracts.

[18] (Ex. 17). The area rate clause in the Mobil contract was different than the other area rate clauses in the Green contracts in that it referenced rates set by policy.

With reference to the 1971 Mobil contract, Mobil, by letter dated March 26, 1979 (Ex. 18 and also Ex. 83), asked NICOR to initial a statement that the intent of the parties was for their contract to cover rates as high as prescribed by the Government. NICOR initialed and returned this letter without comment. Scarth asserts that the Commission erred in finding that the language of the Mobil and the Green contracts is different enough to explain NICOR's differing performance under the contracts. Applying an Opinion No. 77-type analysis, as did the Commission, Scarth asserts that the Commission should have found that the Mobil clause was not broader than the subject Green contracts.

Although we agree with a number of Scarth's objections to the reasoning of the February 21, 1992 order on this issue,[19] we will, nonetheless, deny rehearing on this issue. The central flaw in relying on the Natural and the Mobil contracts is that, even though their area rate clauses were similar or identical to those in the Green contracts, it does not necessarily follow that their meaning was the same to NICOR. The Commission recognized in Opinion No. 77 that, in the matter of contractual intent, some degree of variation is to be expected, even when the pertinent language involved is the same.[20] We find that the record demonstrates enough of a difference in the factual backdrop of the transactions involving Sun, GHK, and Amerada Hess to warrant not giving any special weight to NICOR's actions under other contracts with other par-

---

[19] Upon further consideration on rehearing, the Commission has concluded that the 1970 gas sales contract with Natural was of a standard format and, further that the refund provision in the 1979 letter agreement with Natural has no effect on the evidentiary weight of this letter in ascertaining mutual intent under the original 1970 contract. We also recognize that it was inappropriate to employ the Opinion No. 77 standards in the evidentiary phase of the proceeding.

[20] 10 FERC at pp. 61,400-401.

ties.[21] The only finding that can be made regarding evidence of NICOR's subsequent conduct directly relevant to the Green contracts is that there was none. Prior to Scarth's taking over the Green well, there never was an actual instance of a payment or a refusal to pay an NGPA incentive rate under the subject contracts. Scarth's showing concerning the Mobil and Natural contracts is circumstantial evidence that is due some weight in our decision, but not special weight, and is offset by the direct testimony of NICOR's witnesses. In balancing the evidence, we think Scarth has only shown that the evidence is inconclusive.

3. Usage of Trade

Scarth argues that the Commission erred in relying on *Equitable Gas Company*[22] to find that there is no usage of trade supporting Scarth's position that NICOR intended to pay incentive rates. Scarth argues that more recently, in *Northern Natural Gas Company*,[23] the Commission did in fact find a general usage of trade in the industry that area rate clauses trigger payment of the generally applicable ceiling price.

In *Northern*, the Commission affirmed, *sub silentio*, the finding in an Initial Decision that an industry usage of trade existed to pay the highest lawful rate under an area rate clause, as Scarth argues. However, the Commission

---

[21] For example, we find relevant, though not conclusive, NICOR's testimony that it gave GHK special loans and gave farmouts to Sun and Amerada Hess to induce the producers to sell their respective interests in the Green Well gas to NICOR. (Tr. 282, 285, 348, 452-53; exhibit No. 19) Those additional side considerations would be consistent with NICOR's asserted intent to hold down the potential for future price increases under those contracts.

[22] 20 FERC ¶ 61,048 (1982).

[23] Citing the Initial Decision at 43 FERC ¶ 63,015, at pp. 65,163-65,166 (1988), *aff'd* 48 FERC ¶ 61,177 (1989), *reh'g denied* 50 FERC ¶ 61,288 (1990).

based its actual decision in that case on such things as physical evidence of intent (a letter) and testimony of the witnesses regarding the specific contract at issue and did not specifically rely on the ALJ's usage of trade finding. In any event, the usage of trade discussed in the *Natural* Initial Decision was found to exist at the time the area rate clauses were entered into, i.e., in the 1960's and early 70's before the passage of the NGPA.[24] The Commission has never adopted the position that there was a general industry usage of trade to pay NGPA incentive rates after the passage of the NGPA. Thus, like the other circumstantial evidence Scarth offered, the evidence of a usage of trade in 1970 is entitled to some weight, but not enough to find that the totality of evidence is conclusive to prove a mutual intent under any of the subject area rate clauses. Accordingly, we deny rehearing on this issue.

Conclusion

Upon consideration of the foregoing, we have determined that there is no preponderance of reliable and probative evidence that NICOR and GHK, Sun, and Amerada Hess mutually intended that the three subject contracts cover incentive rates, such as the NGPA section 108 stripper well rate. Nor is there such evidence of a mutual intent under any of the three subject contracts to limit the effect of the area rate clauses to non-incentive cost-based rates. Accordingly, we affirm the ALJ's Initial Decision to the extent he made the same findings. To the extent not specifically addressed above, we find that Scarth has raised nothing new on rehearing of this issue that was not adequately addresed in the February 21, 1992 order.

In Opinion No. 77, the Commission established interpretive standards to ascertain the mutual intent of the

---

[24] 43 FERC ¶ 63,015, at p. 65,164.

parties in light of the changed circumstances of the NGPA when evidentiary proof of such mutual intent is absent or inconclusive.[25] Here, reliable and probative evidence of a *mutual,* i.e., identical, intent of the seller and respective purchasers is absent, or at least inconclusive. It is, therefore, appropriate to decide the contract authority issue as to all three contracts by applying the interpretative standards of Opinion No. 77.

B. *Opinion No. 77 Standards*

Under the Opinion No. 77 interpretative standards, the Commission will generally conclude that a contract containing an area rate clause did not authorize collection of incentive NGPA rates if: (1) the text of the area rate clause refers to rates established by an administrative body, (2) the reference to administrative action is coupled with a reference to the Natural Gas Act (NGA) or to the "just and reasonable" standard of that Act, and (3) the contract contains no additional language having the effect of "uncoupling" the link between agency action and the just and reasonable standard.[26] If either of the first two provisions is not present in the text of the area rate clause, or if the contract contains uncoupling language, then the general rule in section 271.205 applies and the area rate clause must be held to authorize all NGPA ceiling rates.

1. The Amerada Hess contract

In the February 21, 1992 order, the Commission held that, pursuant to the Opinion No. 77 standards, the area rate clause in the Amerada Hess contract does not permit NGPA incentive rates. This clause reads as follows:

> If the Federal Power Commission, or any successor governmental authority having jurisdiction over the

---

[25] 10 FERC ¶ 61,214, at pp. 61,396, 61,400.

[26] 10 FERC at p. 61,398.

> sale of gas hereunder, at any time hereafter prescribes or permits, by order following hearing, or by settlement, for the area in which the gas reserves are situated, an applicable higher price for the sale of gas than the price being paid hereunder at the time, then the price for gas delivered hereunder will be increased effective as of the date such higher price is prescribed or permitted to equal such higher price.

In the February 21, 1992 order, the Commission stated that "references to the NGA and to the just and reasonable standard are implicit in the Amerada Hess clause by virtue of the inclusion of the requirement for the approval of a rate following a hearing, or by settlement." [27] The Commission reasoned that the Commission's only authority for holding a hearing covering the contract rate would be the Natural Gas Act. In his rehearing request, Scarth argues that the Amerada Hess clause does not couple administrative action with a reference to the Natural Gas Act or its "just and reasonable" standard and that this cannot be inferred. Upon further consideration, we conclude that the Amerada Hess clause does allow incentive based NGPA rates.

The Amerada Hess clause does not include any express textual reference either to the "just and reasonable" standard or to "the Natural Gas Act." We agree that it was error to infer, and thereby read in, such language when none existed in the text of the clause.[28] Opinion

---

[27] 58 FERC ¶ 61,203, at p. 61,636.

[28] Moreover, the reference to "any successor governmental authority" can include Congress and, as a result, the first prong of the Opinion No. 77 standard is not necessarily met. *See* discussion, *infra*. Further, we recognize that it is not reasonable to infer only Natural Gas Act authority solely because the clause refers to rates set following a hearing. Eligibility of particular wells for section 108 rates is frequently decided in contested paper hearings before this Commission.

No. 77 requires that the required words appear on the face of the area rate clause.[29] Inferring that the second prong of the Opinion No. 77 standard (a reference to the "just and reasonable" standard or the Natural Gas Act) is met simply by meeting the first prong (a reference to administrative action) would render the second prong superfluous. In the absence of the required express textual references, we must grant rehearing and find that the Amerada Hess contract allows all NGPA rates, including section 108 rates.

2. The Sun and GHK contracts

In the February 21, 1992 order the Commission also found that all three of the Opinion No. 77 conditions were met in the Sun and GHK area rate clauses and, accordingly, held that they also did not authorize the collection of incentive rates. The Sun and GHK area rate clauses are considered together because they are identical. They read as follows:

> If the Federal Power Commission, or any successor governmental authority having jurisdiction in the premises, shall at any time hereafter prescribe, for the area in which the contract is located, a higher, applicable, just and reasonable area rate for the purchase of gas than the price herein provided to be paid, then the price to be paid by Buyer to Seller for gas delivered under the provision of this Agreement shall be increased to equal such higher price effective as of the date such higher price is made applicable to the gas sold hereunder.

---

[29] Opinion No. 77 states that, in those cases where there is no reliable and probative evidence of intent or where such evidence is inconclusive, "the Commission will ascertain the intent of the parties on the basis of the *text of the clause in dispute*," and that the clause must contain "a *reference* to the Natural Gas Act or the 'just and reasonable' standard of that Act." 10 FERC ¶ 61,214 at p. 61,399 (emphasis added).

In the February 21, 1992 order, the Commission held that this clause falls within the Opinion No. 77 guidelines for allowing only cost-based rates on the ground that (1) the clause refers to "the Federal Power Commission or any successor governmental authority," (2) the foregoing text is a reference to administrative action which is coupled with the term "just and reasonable," and (3) the clause contains no uncoupling language. On rehearing, Scarth argues that the foregoing reference to "successor governmental authority" and a general provision of the contracts making the contracts subject to all future laws provide the requisite uncoupling of agency action from the just and reasonable standard.

Upon reconsideration, the Commission finds that the area rate clause in the Sun and Amerada Hess contracts does in fact contain such uncoupling language in that its inclusion of rates set by "any successor governmental authority" permits the collection of rates set by Congress.

The Commission stated in Order No. 23 that the term "successor authority" in an area rate clause can denote Congress.[30] In Opinion No. 77 the Commission also explained that a reference to the Commission was not dispositive of this issue. The Commission stated:

> The fact that a contract refers to rates established by the Commission or by "valid order" does not, in

---

[30] Order No. 23, *FERC Statutes and Regulations, Regulations Preambles 1977-1981* ¶ 30,040, at p. 30,314, note 42. There, the Commission stated that, although it would permit the purchaser to show otherwise:

> We find convincing the arguments that the Congress, in the exercise of direct ratemaking authority, has replaced and, in that sense, succeeded to the Commission's exercise of responsibility in this matter.

Also pertinent here, Opinion No. 77 states that "where a reference to the Natural Gas Act or the 'just and reasonable' standard is supplemented by the phrase 'or successor statutory authority' or words of similar import," such language could uncouple a bond between those provisions. 10 FERC ¶ 61,214, at p. 61,399.

> and of itself, signify that the parties intended to exclude rates imposed by legislative action. The Commission's ratemaking power under the Natural Gas Act was delegated to it by the Congress. We will not assume, in the absence of specific language or reliable and probative evidence, that the parties intended to be bound by an agency determination but not by a mandate emanating from the source of that agency's authority. Hence, we decline to conclude that the mere transfer of the ratemaking function from the Commission to the Congress—most likely unforeseen by the parties at the time the contract was executed—should operate to defeat the intent of the parties simply because they expressed that intent in terminology which was based on the regulatory scheme then in force.
>
> 10 FERC at pp. 61,398-61,399.

Accordingly, the Commission held in Opinion No. 77 that, "if a reference to administrative action is followed by language broad enough to encompass legislative enactments, the clause would appear to indicate that the parties did not intend to be restricted to the outcome of an agency proceeding." [31]

Further, the presence of the term "just and reasonable" in the Sun and GHK area rate clauses also does not, by itself, restrict rate increases only to those set through administrative action. Opinion No. 77 states:

> [T]he parties may have provided in their contract for escalation to a "just and reasonable" rate. That phrase, standing alone, is subject to conflicting interpretations. It may have been used to express an intent to permit collection of the maximum legally permissible prices, since such prices were required

---

[31] 10 FERC ¶ 61,214, at p. 61,408, note 20.

> to be just and reasonable under the governing statute then in effect and since only rates meeting that standard could be assured of being passed through by the purchaser to its customers. If that was what the parties contemplated, we do not believe their intent should be thwarted merely because they failed to foresee that the Congress would assume the ratemaking function previously delegated to the Commission and thus expressed their intent in the terminology of the Natural Gas Act.

10 FERC at p. 61,397.

Indeed, Congress deemed, in section 601(b)(1)(B) of the NGPA, that all NGPA ceiling rates, including incentive rates under section 108, are just and reasonable for purposes of the Natural Gas Act.

In Opinion No. 77, the Commission ruled on the issue of the scope of similar "successor" language (i.e., whether the term "successor" was limited to administrative agencies or whether it could include Congress) by reference to other terms within the context of the particular area rate clauses at issue in that proceeding.[32] In this case there is nothing in the context of subject clauses that can clearly be read as excluding rates set by Congress or in any way limiting the scope of authority exclusively to rates set by an administrative body.[33] The Sun and GHK clauses contain the term "or any successor governmental authority," which is a broad term that can include Congress. The only other word within the context of these clauses that can be used to interpret the phrase "or any successor governmental authority" is the word "prescribe." This also is a broad term that can have

---

[32] 10 FERC ¶ 61,214, at pp. 61,402-61,403.

[33] The evidentiary record supports this interpretation in that there appears to be no objection by NICOR to the collection of Congressionally-prescribed rates. Its evidence was offered to prove only that it intended a limitation to cost-based rates.

reference to rates set by Congress, which actually occurred when Congress subsequently did prescribe natural gas rate ceilings under the Sun and GHK area rate clauses are not restricted to rates set by an administrative body and can reasonably be interpreted to include all the rates set by Congress in the NGPA, without restriction. These terms, therefore, constitute uncoupling language mandating a finding that the Sun and GHK area rate clauses authorize all NGPA ceiling rates, including the section 108 ceiling rate. On this basis, the Commission grants rehearing.

The Commission orders:

Rehearing of the Commission's February 21, 1992 order is granted to the extent set forth in the text above.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Docket No. GP90-11-002

NICOR EXPLORATION COMPANY
ORDER DENYING REHEARING
(Issued March 2, 1994)

Before Commissioners: Elizabeth Anne Moler, Chair; Vicky A. Bailey, James J. Hoecker, William L. Massey, and Donald F. Santa, Jr.

NICOR Exploration Company (NICOR) has requested rehearing of an order issued April 7, 1993, in the captioned proceeding.[1] The April 7, 1993 order held that Robert W. Scarth (successor to Scarth Oil & Gas Co.) (Scarth) was entitled, as a successor under three natural gas sales contracts entered into January 1970, to collect Natural Gas Policy Act of 1978 (NGPA)[2] section 108 stripper well maximum lawful prices for gas produced from a well, known as the Green Well, located in Oklahoma. For the reasons set forth in the April 7, 1993 order, as supplemented below, we deny rehearing.

Background

The three contracts at issue each contain an "area rate" price escalation clause and were entered into in January 1970, when the Commission's predecessor, the Fed-

---

[1] *NICOR Exploration Co.*, 63 FERC ¶ 61,034 (1993).

[2] 15 U.S.C. §§ 3301-3432 (1988).

eral Power Commission (FPC), established rates for producer sales of natural gas pursuant to the just and reasonable standard of the Natural Gas Act. The gas sold under each of these contracts was purchased by NICOR for its parent, Northern Illinois Gas Company (NI-Gas), a large local distribution company serving the Chicago area and transported by Natural Gas Pipeline Company of America (Natural). Scarth is successor in interest to the original producer-sellers under the three contracts: GHK Company (GHK), Sun Petroleum Company (SUN), and Amerada Hess Corporation (Amerada Hess). Nicor's position in the case has been that Scarth lacked contractual authority to collect "incentive" NGPA rates, such as the section 108 stripper well rate, and only could collect the lower "cost-based" section 104 or 106(a) rates. Scarth took the opposite position and asserted it had authority to collect incentive NGPA rates.

Although area rate clauses generally refer to area rates set by the FPC under the Natural Gas Act, the Commission has held that they are ambiguous *vis-a-vis* NGPA ceiling rates set by Congress. However, unless the purchaser is successful in protesting the seller's assertion of contractual authorization, the Commission's rules provide that an area rate clause may operate to authorize the collection of all NGPA ceiling rates.[3] In this case, NICOR protested Scarth's assertion of contractual authority to collect the section 108 ceiling rate for the Green Well first sales. As explained in the April 7, 1993 order, the Commission's area rate clause two-party protest procedures, as originally established in Order No. 23, *et al.*,[4]

---

[3] 18 C.F.R. § 270.205(a)(2) (1992).

[4] Order No. 23, *FERC Statutes and Regulations, Regulations Preambles 1977-1981* ¶ 30,040, *reh'g* 7 FERC ¶ 61,152 (1979); Order No. 23-A, *FERC Statutes and Regulations, Regulations Preambles 1977-1981* ¶ 30,058, *reh'g*, 8 FERC ¶ 61,158 (1979); Order No. 23-B, *FERC Statutes and Regulations, Regulations Preambles 1977-1981* ¶ 30,065, *reh'g FERC Statutes and Regulations, Regulations*

were revised in Opinion No. 77[5] to provide a two-step process. First, there is a hearing to determine by extrinsic evidence whether the parties to the contract had a mutual intent with respect to the operation of the area rate clause and, if so, what that mutual intent was. Second, if there is no reliable and probative extrinsic evidence submitted by the parties or the evidence is inconclusive to permit ascertainment of a *mutual* intent of the parties, the Commission will then decide the matter solely by reviewing the express terms of the area rate clause pursuant to interpretative standards established in Opinion No. 77.

The April 7, 1993 order granted, in part, Scarth's request for rehearing of an order issued February 21, 1992,[6] that affirmed in part and reversed in part an Initial Decision[7] issued September 24, 1991. Following an evidentiary hearing where witnesses who negotiated the subject contracts testified, the Initial Decision held that there is no reliable and probative evidence sufficient to ascertain the mutual intent of the parties and that the evidence of intent might be deemed inconclusive.[8] Accordingly, the ALJ applied the Opinion No. 77 interpretative standards to the language of the area rate clauses in each of the three contracts and then found that, under such standards, the contracts only authorized cost-based NGPA ceiling rates, such as section 104 rates, and not incentive rates, such as the section 108 rate sought by Scarth. The February 21, 1992 order affirmed the holding of the Initial Decision that mutual intent under the Amerada Hess and Sun contracts was not established.

Preambles 1977-1981 ¶ 30,073 (1979). *See also Pennzoil v. FERC*, 645 F.2d 369 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982); *Pennzoil Co. v. FERC*, 789 F.2d 1128 (5th Cir. 1986).

[5] *Independent Oil and Gas Assn. of W. Va.*, 10 FERC ¶ 61,214 (1980).

[6] 58 FERC ¶ 61,203.

[7] 56 FERC ¶ 63,023.

[8] 56 FERC ¶ 63,023, at p. 65,090.

However, the February 21, 1992 order reversed the same holding of the Initial Decision regarding the GHK contract, and found that the record did, in fact, establish a mutual intent under that contract to allow only cost-based (not incentive) rates. The February 21, 1992 order then proceeded to affirm the ALJ's findings on the application of the No. 77 interpretative standards to the Sun and Amerada Hess area rate clauses. Accordingly, the February 21, 1992 order held that Scarth was not entitled to collect the section 108 ceiling rate under any of the subject contracts.

In granting rehearing, in the April 7, 1993 order, the Commission agreed with the ALJ that none of the parties met the burden to show a mutual intent to allow or not allow incentive rates to be charged under any of the contracts. All that the Commission could find was that the evidence was inconclusive on whether NICOR made a case for its alleged intent to have a cost-based limitation, and the producer/sellers made a case that they intended to get the highest lawful rate—but no mutual intent under any of the contracts. In this regard, the Commission observed that NICOR's witness Hefner, who actually negotiated the GHK contract on behalf of the producer, testified under cross examination that he intended to get the highest lawful price and that his intent was materially different than that of NICOR. Further, the Commission found that there was no evidence that the matter of a "cost-based" limitation on the operation of the area rate clauses ever was expressed during the negotiations. Turning to the Opinion No. 77 standards, the Commission found that each of the three area rate clauses allows Congressionally-set incentive rates under those standards.

In its request for rehearing, NICOR urges the Commission to reverse its rulings and, instead, rule that Scarth alone bears the burden of proving the mutual intent of the parties to allow incentive rates and that it failed in that alleged burden. Further, as an independent ground for rehearing, NICOR asserts that application of the

Opinion No. 77 interpretative standards requires a finding that only administratively set, cost-based rates were authorized under all three contracts. The Commission finds that NICOR has raised nothing new that warrants any change in the Commission's April 7, 1993 order. In light of the Commission's full discussion of the issues in the April 7, 1993 order, here we will only specifically address arguments in order to help clarify the basis for the Commission's rulings. Accordingly, our silence here as to any particular statements and assertions by NICOR in its request for rehearing should not be taken as agreement.

Discussion

A. *Burden of Proof and Procedures*

In the April 7, 1993 order, the Commission observed that Opinion No. 77 established a two-step procedure in two-party contract protest cases such as this one.[9] In the first stage, the Commission observed, Opinion No. 77 provided for an evidentiary hearing on the issue of whether the parties to the contract at issue had a mutual intent with respect to the area rate clause. The Commission observed that, under this procedure, if there is no reliable and probative extrinsic evidence submitted by the parties or if the evidence is inconclusive to permit an ascertainment of the mutual intent of the parties, then

---

[9] In a two-party protest case, the purchaser protests the seller's assertion of contractual authority. The question of mutual intent is set for hearing, followed by application of the interpretive standards if a mutual intent cannot be ascertained through the evidentiary process. In a third-party protest case, the purchaser and seller are in agreement that the clause authorizes NGPA incentive rates, but another person, such as a downstream customer, files a protest. In the third-party situation the case is set for evidentiary hearing. Unlike a two-party protest, however, a rebuttable presumption is applied that the parties to the contract are accorded a presumption of validity regarding their mutual interpretation. *See* Opinion No. 77, 10 FERC ¶ 61,214, at pp. 61,398 and 61,400.

the Commission will decide the matter solely by reviewing the express terms of the contract pursuant to the Opinion No. 77 interpretative standards. Since the Commission found that none of the parties produced such evidence of *mutual* intent, the Commission affirmed the ALJ to that extent and, like the ALJ, resolved the matter solely by application of the interpretive standards.

On rehearing, NICOR asserts that it was error for the Commission not to impose the burdens of production and persuasion (collectively, the burden of proof) exclusively on Scarth. Since the Commission found that Scarth failed to prove a mutual intent to authorize incentive rates, NICOR asserts that Scarth failed to meet its alleged burden of proof and should lose. NICOR relies on procedures discussed in the Commission's 1979 order on rehearing of Order No. 23-B [*FERC Statutes and Regulations, Regulations Preambles 1977-1981* ¶ 30,073] wherein the Commission stated that the burden of proof in such cases would be entirely on the party seeking the rate increase, i.e., Scarth. Further, it states that this allocation of the burden of proof to the seller was upheld by the United States Court of Appeals for the Fifth Circuit in three cases.[10] It asserts that, if the Commission intends to construe Opinion No. 77 as it did in the April 7, 1993 order, then Opinion No. 77 itself violated the three cited Fifth Circuit decisions as well as Oklahoma law and Commission precedent.[11] Accordingly, it argues that the Commission committed error when it proceeded to review the contracts under the Opinion No. 77 interpretive standards instead of finding that Scarth failed in its as-

---

[10] *Citing Pennzoil Co. v. FERC*, 645 F.2d 360, 370 (5th Cir. 1981), *cert. denied* 454 U.S. 1142 (1982) (*Pennzoil I*); *Pennzoil Co. v. FERC*, 789 F.2d 1128, 1230 n.9 (5th Cir. 1986) (*Pennzoil*); *Hunt Oil Co. v. FERC*, 853 F.2d 1226, 1230 n.9 (5th Cir. 1988) (*Hunt*).

[11] *Citing Equitable Gas Co.*, 20 FERC ¶ 61,048, at p. 61,101 (1982).

serted evidentiary burden and ruling in NICOR's favor at that point.

The April 7, 1993 order correctly applied the proper procedures and burdens for a "two-party" contract protest case such as this. The April 7, 1993 order did not remove the ultimate burden of proof from Scarth just because it followed the Opinion No. 77 procedures and turned to the Opinion No. 77 interpretive guidelines after finding no mutual intent. Scarth still had the burden of persuasion. The Commission simply found that Scarth met it, for reasons set forth in the order. Under those procedures, as NICOR itself has argued all along in this proceeding until now,[12] if there is no reliable, probative uncontradicted evidence of a *mutual* intent under the subject area area rate clause, then the Opinion No. 77 interpretive standards must be applied to the text of the clause. If, as NICOR now appears to argue, the seller must prove a mutual intent to pay incentive ceiling rates or else lose the case upon the conclusion of the evidentiary phase of the proceeding, then the Opinion No. 77 interpretive standards could never be reached and would be superfluous. In so arguing, NICOR appears to ignore the fact that the Order No. 23 [*FERC Statutes and Regulations, Regulations Preambles 1977-1981* ¶ 30,160] procedures, which provided only for an evidentiary hearing in the process, were modified in Opinion No. 77 to provide for interpretive standards to accomodate those *two-party* protest cases where, as here, neither of the parties could prove a mutual intent by extrinsic evidence. NICOR's reference to statements in *Pennzoil,* to the effect that the Commission may not exclusively rely on the text of the contract, are misplaced in that the court's statements were made in the context of a third-party protest case initiated under that Order No. 23 procedure. The references to the burden on the seller in the various cited Fifth Circuit decisions (*Pennzoil I, Pennzoil,* and *Hunt,*

[12] *See* discussion, *infra.*

supra) also were set in the context of cases commenced under the earlier procedures and, in any event, were *dicta* in that the cases involved "third-party" protests with wholly different burdens and procedures than "two-party" protest cases. Indeed, the court in *Pennzoil I* noted that the Commission's procedures were still evolving, citing Opinion No. 77, and stated that it was taking no position on those new procedures.[13] Here, the ALJ found that neither party met its respective evidentiary burden and, therefore, turned to the Opinion No. 77 interpretive standards. While the Commission later found that the ALJ did not correctly apply those standards to the subject contracts, the ALJ was, nonetheless, correct in the procedures that he followed.

Further, the Commission's application of the Opinion No. 77 procedures in the April 7, 1993 order is fully consistent with the *Equitable* case relied on by NICOR. *Equitable* was a two-party protest case where the producer offered no evidence and argued that, under state law, the pipeline's protest should be summarily denied. The ALJ resolved the case, not on a burden of proof basis for lack of evidence by the seller, but by applying the Opinion No. 77 interpretive standards. The Commission afirmed the ALJ and rejected the producer's contention that there was a usage of trade to allow the highest lawful rate based on evidence that the producer proferred for the first time in its brief on exceptions. Thus, the Commission followed the exact same Opinion No. 77 procedures as in the instant case.

NICOR argues that Oklahoma state law must be applied and that, under that law, it is absurd to take what is ambiguous on its face and, having found no evidence of mutual intent, interpret the clause based on the language of the clause alone. In essence, NICOR is now contesting the core change Opinion No. 77 made in the Order No. 23 procedures: to establish interpretive stand-

---

[13] 645 F.2d at p. 368 n.14.

ards under which an area rate clause would be interpreted in the event that the hearing process failed to identify a mutual intent. Once again, NICOR never complained about this procedure until now, after having lost the case. Indeed, NICOR explained in its initial brief, at page 23, that the Opinion No. 77 interpretive standards are consistent with Oklahoma state law.[14] In any event, Oklahoma state law cannot be relied on to change the Opinion No. 77 procedures and the allocation and description of burdens; it is only relevant regarding whether, for example, course of conduct evidence is relevant and may be used.

It is of interest to note the abrupt change in NICOR's position on procedures from that which it expressed in its own initial brief to the ALJ. There, after reciting the same Order No. 23 language that the burden of proof is on the seller, at pages 19-20, NICOR set forth the identical procedural guidelines recited in the April 7, 1993 order. Of significance, it argued at page 14, that the standards announced in Opinion No. 77 must be applied to find that only cost-based section 104 or 106(a) rates are allowed under the clauses "since there is no 'reliable,' 'probative' and 'conclusive' evidence of a contrary mutual intent of the contracting parties." (*See also* page 17.) At page 24 NICOR urged, correctly, that "[i]n evaluating extrinsic evidence in an ARC [area rate clause] controversy, the touchstone is the *mutual* intent of the contracting parties." (Emphasis in original.) NICOR then proceeded to review and argue against Scarth's contention that the record did show a mutual intent to allow incentive rates—an analysis that was adopted for the most

---

[14] At page 23 of its initial brief, in arguing that the words of the subject clauses meet the Opinion No. 77 interpretive standards for only allowing cost-based rates, Nicor stated:

> Oklahoma law would yield the same result in this case as the rules of construction announced in Order No, 23 and Opinion No. 77. Oklahoma law emphasizes construction of a contract in accordance with its literal terms whenever possible.

part by the ALJ and *both* Commission orders in this case. NICOR never argued as now that, based on the record, "NICOR and Amerada only had a mutual intent to the payment and collection of cost-based prices." [15] Accordingly, its attacks on the Commission's application of the Opinion No. 77 procedures are purely an afterthought on its part and a collateral attack on Opinion No. 77.

B. *The Evidentiary Record*

Before turning to NICOR's claims about what the record shows, we will address several claims of error that NICOR makes that rest on its misconstruction of what the ALJ and the February 21, 1992 order actually said and did. NICOR asserts that the April 7, 1993 order misconstrued both the underlying ALJ decision and the February 21, 1992 order in that, according to NICOR, the ALJ did not rest his decision solely on the Opinion No. 77 standards but carefully considered all the evidence. Therefore, it asserts, the Commission is confused and, NICOR argues, the February 21, 1992 order did not reverse the ALJ's holding regarding the GHK contract. NICOR is in error. In the evidentiary portion of his Initial Decision, the ALJ did indeed carefully review all the evidence but found that none of the parties supported a finding of mutual intent regarding any of the contracts, including the GHK contract. For that reason, the ALJ applied the Opinion No. 77 interpretive standards to each of the contracts, including the GHK contract.[16] The February 21, 1992 order found that, con-

[15] NICOR Request for Rehearing at p. 72.

[16] NICOR relies on the portion of the ALJ's Initial Decision where, having found that the record did not contain conclusive reliable and probative evidence of a mutual intent and having decided the issue using the Opinion No. 77 interpretive standards, the ALJ proceeded to discuss Scarth's argument that it had proven its case. 56 FERC ¶ 63,023, at p. 65,090. However, the ALJ made it clear that he was only focussing on Scarth's evidence and concluded only that that evidence failed to prove a mutual intent to

trary to the finding of the ALJ, there was substantial evidence of a mutual intent regarding the GHK contract (but not as to the other contracts) and decided the issue as to the GHK contract solely on the evidence without applying the Opinion No. 77 standards to that contract. Therefore, the February 21, order 1992 did, in fact, reverse the ALJ as to his evidentiary finding regarding the GHK contract even though it affirmed the ALJ's ultimate conclusion, albeit on different grounds, that Scarth lacked contractual authorization to collect the section 108 rate under that contract.

In a lengthy portion of its request for rehearing, NICOR asserts that the Commission erred in the April 7, 1993 order in not affirming what it asserts was the ALJ's finding that the parties did not mutually intend to pay incentive-based rates. Again, NICOR only confuses things. The April 7, 1993 order expressly adopted the ALJ's finding that the record lacked conclusive evidence of a mutual intent under the subject clauses. That meant that the ALJ found, and the Commission agreed, that Scarth failed to prove a mutual intent to authorize the payment of incentive rates. However, this also means that NICOR did not prove by a preponderance of the evidence that the parties had the mutual intent to limit area rate clause price escalations to only cost-based rates. Under the procedures established in Opinion No. 77, to win the case at the evidentiary stage and not reach the interpretive standards, NICOR had to prove by extrinsic evidence that its alleged intent was shared by each of the producer/sellers.

Turning to issues NICOR raises regarding the evidence in the case, one of the key evidentiary findings of the case

---

pay incentive-based rates. That finding cannot be extrapolated to support either NICOR's position that NICOR did not also have an evidentiary burden to prove *mutual* intent in order to win the case without resorting to the Opinion No. 77 interpretive standards or its new alternative position that it did, in fact, meet that evidentiary burden.

was the Commission's finding in the April 7, 1993 order that, based on the cross examination of NICOR's witnesses and NICOR's concession in its brief, there was no evidence that the matter of a "cost-based" limitation on the operation of the subject area rate price escalation clauses was ever expressed during the contract negotiations. This was an important finding because, if NICOR's negotiators had actually stated during the negotiations that it intended such a cost-based limitation, the producers' silence in the face of such an express statement would cause them to lose. On rehearing, NICOR asserts that the Commission "totally mis-cites" NICOR's Brief Opposing Exceptions and "remarkably misconstrues" the testimony of its witness Parson, as assertedly corroborated by witness Hefner. It asserts that Parsons "clearly and unqualifiedly testified that he expressed to each of the producer/sellers that NICOR would only agree to a pricing mechanism based on costs." [17] Thus, NICOR now argues for the first time that it has indeed proven by this alleged evidence of express notice of a limitation to cost-based rates that it was the *mutual* intent of the parties to allow increases only to cost-based rates under the subject area rate clauses.[18]

The Commission accurately represented the record. It is NICOR that has misconstrued its own brief and the testimony *under cross-examination* of its own wit-

---

[17] NICOR Request for Rehearing at p. 53 (*citing* Tr. 339 for Parsons and Ex. 21 at p. 7, Tr. 437 and 439 for Hefner).

[18] The balance of NICOR's request for rehearing is taken up with a lengthy repetition of its arguments that Scarth failed to prove a mutual intent to allow incentive rates under the subject clauses. In the April 7, 1993 order the Commission *denied* Scarth's request for rehearing to the extent that Scarth had asserted such a *mutual* intent was proven. To the extent that NICOR now asserts that its same arguments prove a mutual intent to *not allow* incentive rates, it has gone beyond its own previous position in the case regarding the Amerada Hess and Sun contracts and has extrapolated too much from the evidence.

nesses by reading things in that do not exist in the record and by downplaying what does exist in the record. NICOR merely reiterates its reliance on statements its witnesses made in prepared direct testimony that they recanted later under cross-examination. The April 7, 1993 order relied on NICOR's own concession at pages 32-33 of its Brief Opposing Exceptions that, on cross-examination, "Mr. Parson could not recall using the precise term 'cost-based.'" As noted above, this was an important admission and directly contradicted what Parsons had stated in prepared direct testimony. The entire context of the pertinent colloquy at Tr. 339-340 demonstrates that witness Parson merely assumed (obviously incorrectly) that the producer/sellers would have the same understanding as he and never expressly stated his alleged intent during the negotiations.

BY MR.GOLDEN:

Q Mr. Parson, let's get right down to the nut of the thing.

Is there any doubt in your mind at all about whether or not you expressed to GHK, Sun and Amerada that NI-Gas and Northern Illinois Gas would only pay cost-based prices for gas?

A I have no doubt whatever about the fact that that's what our expressions and discussions were.

Q How can you—

PRESIDING JUDGE: Just a moment. I'm a little confused, Mr. Parson. I thought that nothing about cost-based was discussed. It was all area rate, not cost-based at all.

A I regard cost-based and area pricing in the context of this case, sir, as being synonymous.

PRESIDING JUDGE: That's all right. I agree with you. But specifically, the question has been

asked whether the term "cost-based" was used, not the synonym or anything else, to your recollection.

THE WITNESS: No, we probably did not talk specifically about cost-based because, in my opinion, at that time it wasn't necessary.

PRESIDING JUDGE: For whatever the reason, it was not discussed, I take it.

Witness Parson had no response to give to the ALJ's last observation and neither does NICOR now. Moreover, the only thing that witness Hefner "corroborated" at Tr. 439 cited by NICOR was that he also could not recall that the term "cost-based" rates ever came up during the negotiations.[19] Further cross examination of witness Hefner reflects his denial of hearing any express statement by NICOR of a cost-based limitation on the operation of the subject area rate clause.[20] Indeed, as the

---

[19] Contrary to NICOR's assertion, witness Hefner could not recall what terms were used to describe the area rate clause and was studiedly noncommital in his answer regarding what was actually expressed during the negotiations. The following colloquy appears at Tr. 439:

Q Without regard to whether or not Mr. Maurath and Mr. Parson [Nicor's witnesses] ever used the words "cost-based," as Ms. Skancke referred to it, did Mr. Maurath and Mr. Parson make clear to you that they intended through the pricing provision of the contract to pay rates that were regulated and determined to be just and reasonable by the appropriate regulatory authorities?

A Well, I don't remember the specific words used in our negotiation. All I can say is that from my own standpoint, I feel very comfortable that saying that Ni-Gas Supply and its representatives work[ed] very hard to protect them[selves] to their fullest under the various regulatory schemes that existed as I stated earlier in the testimony.

[20] The following colloquy occurred at Tr. 442, where witness Hefner was asked about his statement at page 7 of his prepared testimony that NICOR asserts corroborates Parson's testimony:

April 7, 1993 order pointed out, witness Hefner recanted any alleged "corroboration" in earlier prepared testimony that NICOR relies on by stating on cross-examination that, as a producer: (1) he "was seeking to get the highest rate allowed by law," (2) GHK did not have any intent under the area rate clause "to limit the rate we [GHK] could collect to a rate less than the maximum the law would allow," and (3) as to whether the "stated intent" of NICOR's witnesses was the same intent GHK had, "No. I would say it was materially different." [21]

The most that the record reflects is witness Hefner's recollection that the NICOR negotiators were quite conservative and vigorously protected their company's interests during the negotiations. But, contrary to NICOR's assertion on rehearing, that hardly amounts to an admis-

---

Did Mr. Maurath and Mr. Parson express the intent which they have stated in their testimony to you in the words that are included in their testimony when you were negotiating the contract, if you recall?

A Did they use the words that I have read, you mean, in their written statements in this proceeding?

Q Yes. Did they use those words?

A At the time they negotiated the contract with us?

Q Exactly, Mr. Hefner.

A I don't know.

[21] Tr. 397, 442. *See also* Tr. 398, where witness Hefner stated: "I can say as a producer, we were looking to get the highest prices that our lawyers could figure out a way to get within the regulatory framework that we were dealing with." Thereafter, the following colloquy ensued:

Q When in your testimony you refer to the highest rate the law will allow, are you refering to a ceiling rate set by the Federal Power Commission or a ceiling rate set by the Illinois Commerce Commission?

A I was not being specific and again, I'd like reiterate that my intent as a producer was to get whatever price that our lawyers could figure out a way to get. Obviously, we wanted the highest price that we could get under the regulatory framework.

sion by Hefner that NICOR's negotiators communicated to him NICOR's alleged intent to limit the operation of the area rate clause so as to not always permit escalation to the highest lawful rate.[22]

Essentially, NICOR's witness Parson's position was that a cost-based limitation was implicit, even though not stated in so many words, because everyone knew and would have agreed on what an area rate clause meant back in 1970.[23] Obviously not. The producer witnesses all disputed NICOR's position and none could recall any cost-based limitation expressed at the negotiations.[24] All that the record shows is that the producers meant to get the highest rate allowed by law and that, while not conclusively supported,[25] NICOR offered testimony that it

---

[22] The following colloquy at Tr. 441 demonstrates how NICOR has read too much into Hefner's testimony.

> Q Were you concerned that this intent by Mr. Maurath and Mr. Parson to protect themselves had any impact on your ability to collect the maximum rate permitted by law?
>
> A I suspect not. I felt we too were well represented and that we were free to do whatever we could under the regulatory scheme.

[23] *See, e.g.*, Tr. 335, where witness Parson testified: "We all understood that an area rate is what the FPC had ruled an area rate clause was and that area rate clauses by their nature under the FPC decisions were cost-based." But, there is no record support for this asserted mutual understanding by the producers and, in fact, the record shows the opposite, i.e., the producers intended to get the highest lawful rate with no other limitation.

[24] NICOR notes, correctly, that none of the witnesses for Sun and Hess could recall anything that was said to them about Nicor's intentions under the area rate clauses of their contracts. NICOR Request for Rehearing at p. 53. Although NICOR attempts to use this in its own defense, it simply shows that the record does not contain evidence that Nicor's representatives ever expressed its alleged intent to limit the operation of the subject area rate clauses to less than the highest lawful rate.

[25] For example, noticeably absent from Nicor's request for rehearing is an explanation of why, as observed in the April 7, 1993

meant to pay only price escalations to cost-based rate levels. It defies logic and the natural self-interest of the producers to contend that they would *implicitly* agree to forgo a price increase to a lawful level otherwise applicable to their production just because of the manner in which the increased rate was established. NICOR cannot extract from the record a statement that the all-important phrase "cost-based" was ever *expressly* stated as an intended limitation on the operation of any of the subject area rate price escalation clauses. The record simply reflects that, during the negotiations, none of the contract negotiators recall ever breaching the subject of how the subject area rate clauses were to operate.[26] Accordingly, based on this fact and a review of the other evidence of record, the April 7, 1993 order correctly affirmed the ALJ's finding that "there is no reliable and probative evidence sufficient to ascertain the mutual intent of the parties and the evidence of such intent might be deemed inconclusive." [27]

B. *Application of the Opinion No. 77 Interpretive Standards*

On rehearing, NICOR asserts that the Commission failed to properly apply the Opinion No. 77 interpretive standards to the clauses at issue. Before turning to their specific arguments it would be helpful to set forth again the Opinion No. 77 interpretive standards. Under the Opinion No. 77 interpretive standards, the Commission will generally conclude that a contract containing an area rate clause did not authorize collection of all NGPA rates (and, therefore, only authorized collection of

---

order, it agreed to pay a non-cost-based prevailing "in-line" rate of 21 cents per Mcf while, at the same time, allegedly demanding that the area rate clause only permit cost-based escalations in that base rate. See 63 FERC ¶ 61,034, at p. 61,181 n.14.

[26] *See, e.g.*, Tr. 455 cited at footnote 14 of the April 7, 1993 order.

[27] 56 FERC ¶ 63,023, at p. 65,090.

cost-based rates) if all three of the following factors are present: (1) it refers to rates established by an administrative body, (2) the reference to administrative action is coupled with a reference to the Natural Gas Act (NGA) or to the "just and reasonable" standard of that Act, and (3) it contains no language having the effect of "uncoupling" the link between agency action and the just and reasonable standard.[28] Thus, if either of the first two requirements is not present in the text of the area rate clause, or if the contract contains uncoupling language, then the general rule in section 271.205 applies and the area rate clause must be held to authorize all NGPA ceiling rates.

1. The Amerada Hess contract

In the April 7, 1993 order, the Commission held that, pursuant to the Opinion No.77 standards, the area rate clause in the Amerada Hess contract permits NGPA incentive rates. This clause reads as follows:

> If the Federal Power Commission, or any successor governmental authority having jurisdiction over the sale of gas hereunder, at any time hereafter prescribes or permits, by order following hearing, or by settlement, for the area in which the gas reserves are situated, and applicable higher price for the sale of gas than the price being paid hereunder at the time, then the price for gas delivered hereunder will be increased effective as of the date such higher price is prescribed or permitted to equal such higher price.

In the April 7, 1993 order, the Commission observed that the Amerada Hess clause does not include any express textual reference either to the "just and reasonable" standard or to "the Natural Gas Act." The Commission

---

[28] 10 FERC at p. 61,398.

found that it was error to infer, and thereby read in, such language when none existed in the text of the clause,[29] in that Opinion No. 77 requires that the required words appear on the face of the area rate clause.[30] Accordingly, the Commission held that, in the absence of the required express textual references, the Amerada Hess contract had to be interpreted to allow all NGPA rates, including section 108 rates.

On rehearing, NICOR asserts that it was error not to infer that the second prong of the Opinion No. 77 standards was met. NICOR asserts that Opinion No. 77 does not require that the words "just and reasonable" appear in the text of the area rate clause. In support of this contention, NICOR cites *Oklahoma Gas Gathering Company*,[31] where, it observes, the term "just and reasonable" did not appear in the text and "[t]he closest reference was to a proceeding instituted in accordance with the Natural Gas Act." [32] NICOR's argument contains the very reason why it must be rejected. Opinion No. 77 required an express reference *either* to the "just and reasonable" standard *or* the Natural Gas Act to meet the second of the three requirements of that opinion. The text of the area rate clause in the *Oklahoma* case expressly referred to the Natural Gas Act whereas the Hess area rate clause

---

[29] Further, we recognize that it is not reasonable to infer only Natural Gas Act authority solely because the clause refers to rates set following a hearing. Eligibility of particular wells for section 108 rates is frequently decided in contested paper hearings before this Commission.

[30] Opinion No. 77 states that, in those cases where there is no reliable and probative evidence of intent or where such evidence is inconclusive, "the Commission will ascertain the intent of the parties on the basis of the *text of the clause in dispute.*" 10 FERC ¶ 61,214, at p. 61,399 (emphasis added).

[31] 23 FERC ¶ 61,654 (1983).

[32] NICOR Request for Rehearing at p. 41.

did not. Hence, nothing was inferred in the *Oklahoma* case; the clause met the second prong on its face.

NICOR further aserts that the references to actions by "order" or by "settlement" cannot contemplate a mandate emanating from Congress and, according to NICOR, these terms therefore demonstrate that the clause contemplated action under the Natural Gas Act meeting the second prong of the test. NICOR's argument confuses the issue of whether prong one is met (reference to administrative action) with the independent requirement of prong two (reference to "just and reasonable" or Natural Gas Act). Once again, if showing that prong one is met will also meet prong two, then prong two would be superfluous. Showing that the Amerada Hess clause contemplated administrative actions cannot meet the independent requirement of prong two.[33] Without the express wording required by prong two, it was reasonable to conclude that the Amerada Hess clause does not preclude the collection of any particular ceiling rate and, thus, allows the collection of the section 108 rate.

2. The Sun and GHK contracts

In the April 7, 1993 order the Commission found that the Sun and GHK area rate clauses contained language uncoupling the first and second of the Opinion No. 77 requirements and, accordingly, held that they also author-

---

[33] As discussed in the April 7, 1993 order, there are two other grounds for rejecting NICOR's arguments. 63 FERC ¶ 61,034, at p. 61,185 n.28. First, since the Commission had to rule by order following paper hearings on whether producers met the NGPA section 108 stripper well volumetric and filing requirements, there is nothing internally inconsistent about a clause that allows price escalations to incentive NGPA rates authorized by Commission order following a hearing. Second, as we discuss in the next section, the reference to "any successor governmental authority" would uncouple any alleged link only to cost-based "just and reasonable" rates.

ized the collection of incentive rates. The Sun and GHK area rate clauses are considered together because they are identical. They read as follows:

> If the Federal Power Commission, or any successor governmental authority having jurisdiction in the premises, shall at any time hereafter prescribe, for the area in which the contract is located, a higher, applicable, just and reasonable area rate for the purchase of gas than the price herein provided to be paid, then the price to be paid by Buyer to Seller for gas delivered under the provisions of this Agreement shall be increased to equal such higher price effective as of the date such higher price is made applicable to the gas sold hereunder.

The Commission held that the phrase "or any successor governmental authority" reasonably included Congress as recognized by Order No. 23 and Opinion No. 77. Consistent with the requirement of Opinion No. 77 that all three prongs must be independently met, the Commission also found that the reference to the "just and reasonable" standard (meeting prong two) did not restrict the "successor" language to administrative actions meeting prong one. The Commission also observed that, in NGPA section 601(b)(1)(B), Congress deemed all NGPA ceiling rates, including incentive rates under section 108 to be just and reasonable. Finally, the Commission found that, since Congress prescribed ceiling rates in the NGPA, the use of that term supported this finding. Accordingly, in the absence of other language clearly excluding rates set by Congress or limiting in any way the scope of authority exclusively to rates set by an administrative body, the Commission found that the foregoing "successor governmental authority" language constituted "uncoupling" language under prong three and held that the Sun and GHK contracts authorize all NGPA ceiling rates, including section 108.

On rehearing, NICOR asserts that the three contracts contain no "uncoupling" language and the Commission's ruling conflicts with Commission precedent, citing *Equitable, supra, Oklahoma, supra,* and Opinion No. 77 itself. The Commission disagrees and finds that these cases are distinguishable on their facts from the instant area rate clauses. The area rate clause at issue in each of these cited cases was found to limit the rate-setting actions of any "successor governmental authority" to that of an administrative agency, and not Congress, because each clause required that the rates be prescribed only through administrative-type actions. The clauses at issue in *Equitable* and Opinion No. 77 were limited to actions pursuant to a "valid order." The clause at issue in *Oklahoma* was limited to rates resulting from "hearing, rulemaking or Commission approved settlement in a proceeding instituted in accordance with the Natural Gas Act." [34] The same limiting language found so important in the cases cited is not present in either the Sun or the GHK clauses. For NICOR to assert that the identical intent should be imputed to these differently worded clauses is contrary to its own arguments, in response to similar arguments of a Scarth witness, that "It simply defies logic and common sense to suggest that all these *differently* worded area rate clauses mean exactly the same thing." [35]

Further, NICOR is in error in asserting that it is not reasonable to conclude that the term "successor governmental authority" presumptively includes Congress. NICOR's contention was laid to rest by the court in *Pennzoil I* where the court stated:

> Much of the dispute over the application of contract law concerns variant escalation clauses. Many of

---

[34] 23 FERC at p. 61,654. The reference to a "proceeding" instituted in accordance with the "Natural Gas Act" reflects a reference to NGA section 4 or 5 administrative proceedings and meets prong one as well as prong two of the Opinion No. 77 standards.

[35] NICOR Request for Rehearing at p. 89 (emphasis in original).

these variants provided the additional language "other governmental authority" or "successor governmental authority" concerning prices prescribed by the "Commission." It is clear that Congress is a governmental authority with the power to prescribe ceiling rates of general applicability that are in the public interest, and that it is an "other" governernmental authority. Since Congress delegated its ratemaking authority to the FPC and then re-assumed that ratemaking function with the enactment of the NGPA, Congress is not the delegatee of the FPC. It is, however, its successor since a successor is one who follows or takes the place of another in the sense of serial replacement, so that a delegator can succeed or replace its delegatee. Whether the use of "successor" was so intended to include Congress, however, depends on how the parties use that term in the contract.[36]

Thus, although the Sun and GHK clauses refer to the FPC, thereby meeting prong one, the allowance for rates set by any successor agency, which includes Congress, uncouples any linkage of the reference to "just and reasonable rates" to *only* administrative proceedings. Obviously, any area rate clause necessarily permits price increases set by an administrative agency such as the FPC or FERC; the issue in these cases has always been whether such clauses *also* allow rate increases prescribed by Congress. If so, as the Commission found here, then there is no restriction, i.e., no "link," only to administrative proceedings.

Finally, Opinion No. 77 stated that where the contract has such uncoupling language, the Commission would generally conclude that the contract authorizes collection of all NGPA rates unless reliable and probative evidence

---

[36] 645 F.2d 360, at p. 389 n.60.

demonstrates otherwise.[37] In the April 7, 1993 order, the Commission found that the evidentiary record supports this conclusion because there appears to be no objection by NICOR to Congressionally set rates and that it only offered to prove that it intended a limitation to cost-based rates.[38] On rehearing, NICOR now appears to assert that its evidence also shows a restriction to the type of rate-setting authority (administrative agencies), and not just to the type of rates (cost-based) authorized. We find that the record does not contain that disqualifying measure of evidence. A review of NICOR's Initial Brief and its Brief Opposing Exceptions shows that its evidence only was offered to prove an intent to pay cost-based rates. It was only in applying the Opinion No. 77 interpretive standards (which it now asserts are unlawful) that NICOR approached the issue of what type of ratemaking forum was contemplated (Congress or an administrative agency).

The Commission orders:

Rehearing of the Commission's April 7, 1993 order is denied.

---

[37] 10 FERC ¶ 61,214, at p. 61,399.

[38] 63 FERC ¶ 61,034, at p. 61,186 n.33.

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 94-40246

NICOR EXPLORATION COMPANY,
Petitioner,
versus
FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

Petition for Review of an Order of the
Federal Energy Regulatory Commission

ON PETITION FOR REHEARING AND
SUGGESTION FOR REHEARING EN BANC

(July 5, 1995)

Before REYNALDO G. GARZA, DAVIS and BARKSDALE, Circuit Judges.

PER CURIAM:

(✔) The Petition for Rehearing is DENIED and no member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, (FRAP and Local Rule 35) the Suggestion for Rehearing En Banc is also DENIED.

ENTERED FOR THE COURT:

/s/ W. Eugene Davis
W. EUGENE DAVIS
United States Circuit Judge

APPENDIX D

STATUTORY PROVISIONS OF THE NATURAL GAS ACT

§ 4, 15 U.S.C. § 717c. Rates and charges; schedules; suspension of new rates

(a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

* * * *

(c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from June 21, 1938) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

* * * *

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commisison or gas distributing company, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfuness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon,

the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commisison may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

June 21, 1938, c. 556, § 4, 52 Stat. 822; May 21, 1962, Pub.L. 87-454, 76 Stat. 72.

§ 5, 15 U.S.C. § 717d. Fixing rates and charges; determination of cost of production or transportation

(a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

* * * *

June 21, 1938, c. 556, § 5, 52 Stat. 823.

§ 19, 15 U.S.C. § 717r. Rehearings; court review of orders.

* * * *

(b) Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Co-

lumbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of Title 28. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 346 and 347 of Title 28.

* * * *

June 21, 1938, c. 556, § 19, 52 Stat. 831; June 25, 1948, c. 646, § 32(a), 62 Stat. 991; May 24, 1949, c. 139, § 127, 63 Stat. 107; Aug. 28, 1958, Pub.L. 85-791, § 19, 72 Stat. 947.

STATUTORY PROVISIONS OF THE NATURAL GAS POLICY ACT

§ 2, 15 U.S.C. § 3301. Definitions

For purposes of this chapter—

* * * *

(11) New contract.—The term "new contract" means any contract, entered into on or after November 9, 1978, for the first sale of natural gas which was not previously subject to an existing contract.

(12) Rollover contract.—The term "rollover contract" means any contract, entered into on or after November 9, 1978, for the first sale of natural gas that was previously subject to an existing contract which expired at the end of a fixed term (not including any extension thereof taking effect on or after November 9, 1978) specified by the provisions of such existing contract, as such contract was in effect on November 9, 1978, whether or not there is an identity of parties or terms with those of such existing contract.

(13) Existing contract.—The term "existing contract" means any contract for the first sale of natural gas in effect on November 8, 1978.

(14) Successor to an existing contract.—The term "successor to an existing contract" means any contract, other than a rollover contract, entered into on or after November 9, 1978, for the first sale of natural gas which was previously subject to an existing contract, whether or not there is an identity of parties or terms with those of such existing contract.

* * * *

§ 101, 15 U.S.C. § 3311. Inflation adjustment; other general price ceiling rules

* * * *

(b) Rules of general application.—

* * * *

(5) Sales qualifying under more than one provision.—If any natural gas qualifies under more than one provision of this subchapter providing for any maximum lawful price or for any exemption from such a price with respect to any first sale of such natural gas, the provision which could result in the highest price shall be applicable.

* * * *

(9) Effect on contrast price.—In the case of—

(A) any price which is established under any contract for the first sale of natural gas and which does not exceed the applicable maximum lawful price under this subchapter, or

(B) any price which is established under any contract for the first sale of natural gas which is exempted under part B of this subchapter from the application of a maximum lawful price under this subchapter,

such maximum lawful price, or such exemption from such a maximum lawful price, shall not supersede or nullify the effectiveness of the price established under such contract.

(Pub.L. 95-621, Title I, § 101, Nov. 9, 1978, 92 Stat. 3356.)

§ 104, 15 U.S.C. § 3314. Ceiling price for sales of natural gas dedicated to interstate commerce

(a) Application.—In the case of natural gas committed or dedicated to interstate commerce on November 8,

1978, and for which a just and reasonable rate under the Natural Gas Act was in effect on such date for the first sale of such natural gas, the maximum lawful price computed under subsection (b) of this section shall apply to any first sale of such natural gas delivered during any month.

(b) Maximum lawful price.—

(1) General rule.—The maximum lawful price under this section for any month shall be the higher of—

(A)(i) the just and reasonable rate, per million Btu's, established by the Commission which was (or would have been) applicable to the first sale of such natural gas on April 20, 1977, in the case of April 1977; and

(ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month, or

(B) any just and reasonable rate which was established by the Commission after April 27, 1977, and before November 9, 1978, and which is applicable to such natural gas.

(2) Ceiling prices may be increased if just and reasonable.—The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—

(A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and

(B) just and reasonable within the meaning of the Natural Gas Act.

(Pub.L. 95-621, Title I, § 104, Nov. 9, 1978, 92 Stat. 3362.)

§ 108, 15 U.S.C. § 3318. Ceiling price for stripper well natural gas.

(a) General rule.—In the case of any first sale of stripper well natural gas the maximum lawful price under this section for such natural gas delivered during any month shall be—

(1) $2.09 per million Btu's, in the case of May 1978; and

(2) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subsection for the preceding month multiplied by the monthly equivalent of a factor equal to the sum of—

(A) the annual inflation adjustment factor applicable for such month; plus

(B)(i) .035, in the case of any month beginning before April 20, 1981; or

(ii) .04, in the case of any month beginning after April 20, 1981.

(b) Definition of stripper well natural gas.—

(1) General rule.—Except as provided in paragraph (2), the term "stripper well natural gas" means natural gas determined in accordance with section 3413 of this title to be nonassociated natural gas produced during any month from a well if—

(A) during the preceding 90-day production period, such well produced nonassociated natural gas at a rate which did not exceed an average of 60 Mcf per production day during such period; and

(B) during such period such well produced at its maximum efficient rate of flow, determined in accordance with recognized conservation practices designed to maximize the ultimate recovery of natural gas.

(2) Production in excess of 60 Mcf.—The Commission shall, by rule, provide that, if nonassociated natural gas produced from a well which previously qualified as a stripper well under paragraph (1) exceeds an average of 60 Mcf per production day during any 90-day production period, such natural gas may continue to qualify as stripper well natural gas if the increase in nonassociated natural gas produced from such well was the result of the application of recognized enhanced recovery techniques.

(3) Definitions.—For purposes of this subsection—

(A) Production day.—The term "production day" means—

(i) any day during which natural gas is produced; and

(ii) any day during which natural gas is not produced if production during such day is prohibited by a requirement of State law or a conservation practice recognized or approved by the State agency having regulatory jurisdiction over the production of natural gas.

(B) 90-day production period.—The term "90-day production period" means any period of 90 consecutive calendar days excluding any day during which natural gas is not produced for reasons other than voluntary action of any person with the right to control production of natural gas from such well.

(C) Nonassociated natural gas.—The term "nonassociated natural gas" means natural gas which is not produced in association with crude oil.

(Pub.L. 95-621, Title I, § 108, Nov. 9, 1978, 92 Stat. 3367.)

§ 506, 15 U.S.C. § 3416. Judicial review

(a) Orders.—

* * * *

(4) Judicial review.—Any person who is a party to a proceeding under this chapter aggrieved by any final order issued by the Commission in such proceeding may obtain review of such order in the United States Court of Appeals for any circuit in which the party to which such order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia circuit. Review shall be obtained by filing a written petition, requesting that such order be modified or set aside in whole or in part, in such Court of Appeals within 60 days after the final action of the Commission on the application for rehearing required under paragraph (2). A copy of such petition shall forthwith be transmitted by the clerk of such court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of Title 28. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to such order of the Commission shall be considered by the court if such objection was not urged before the Commission in the application for rehearing unless

there was reasonable ground for the failure to do so. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as the court deems proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive. The Commission shall also file with the court its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final subject to review by the Supreme Court of the United States upon certiorari or certification as provided in section 1254 of Title 28.

* * * *

§ 601, 15 U.S.C. § 3431. Coordination with Natural Gas Act[1]

* * * *

(b) Charges deemed just and reasonable.—

(1) Sales.—

(A) First sales.—Subject to paragraph (4), for purposes of sections 4 and 5 of the Natural Gas Act, any amount paid in any first sale of

---

[1] This section was replaced in 1989 by 15 U.S.C. § 3431(b)(1)(A).

natural gas shall be deemed to be just and reasonable if—

(i) such amount does not exceed the applicable maximum lawful price established under subchapter I of this chapter; or

(ii) there is no applicable maximum lawful price solely by reason of the elimination of price controls pursuant to part B of subchapter I of this chapter.

* * * *

STATUTORY PROVISIONS OF THE OKLAHOMA CODE

Okla. Stat. Ann. tit. 12, § 577.1. Oklahoma Uniform Jury Instructions—Institution of

Inasmuch as many judgments in actions tried by juries are set aside and vacated on account of errors in instructions; and, whereas, justice is withheld, delayed, and, in some cases, denied on account of such erroneous instructions; and, the compilation and adoption of a body of uniform instructions in civil and criminal cases tried by juries in the courts of this state is necessary to the equal and uniform administration of justice; and, whereas, the justices and judges of the appellate courts of this state are in the best position to properly prescribe such instructions on this subject to the Legislature; the Supreme Court of the State of Oklahoma and the Court of Criminal Appeals of Oklahoma are respectively requested and authorized to proceed to prescribe and institute uniform instructions to be given in jury trials of civil or criminal cases, such instructions to be called: "Oklahoma Uniform Jury Instructions." (OUJI).

Okla. Stat. Ann. tit. 12, § 577.2. Use of instructions—Requests—Copies

Whenever Oklahoma Uniform Jury Instructions (OUJI) contains an instruction applicable in a civil case or a criminal case, giving due consideration to the facts and the prevailing law, and the court determines that the jury should be instructed on the subject, the OUJI shall be used unless the court determines that it does not accurately state the law. Whenever OUJI does not contain an instruction on a subject on which the court determines that the jury should be instructed, the instruction given on that subject should be simple, brief, impartial and free from argument. Counsel for either party or parties shall have a right to request instructions by so requesting in writing.

Each instruction shall be accompanied by a copy, and a copy shall be delivered to opposing counsel. In addition to numbering the copies and indicating who tendered them, the copy shall contain a notation substantially as follows:

"OUJI No. " or "OUJI No. Modified" or "Not in OUJI" as the case may be.

Okla. Stat. Ann. tit. 12, § 2301. Definitions

As used in this Code:

1. A "presumption" is a rule of procedure which means that when a basic fact exists the existence of another fact must be assumed, whether or not the basic fact has any probative value of the existence of the assumed fact;

2. "Basic fact" means the fact or group of facts giving rise to a presumption;

3. "Presumed fact" means the fact which must be assumed; and

4. "Inconsistent presumptions" means the presumed fact of one presumption is inconsistent with the presumed fact of another presumption.

Okla. Stat. Ann. tit. 12, § 2302. Establishment of Basic Fact

The basic fact of a presumption may be established in an action by the pleadings, or by stipulation of the parties, or by judicial notice, or by evidence.

Okla. Stat. Ann. tit. 12, § 2303. Effect of Presumptions in Civil Cases

Except when otherwise provided by law, when the basic fact of a presumption has been established as provided in Section 302 of this Code:

1. If the basic fact has any probative value of the existence of the presumed fact, the presumed fact shall be assumed to exist and the burden of persuading the trier of fact of the nonexistence of the presumed fact rests on the party against whom the presumption operates; or

2. If the basic fact does not have any probative value of the existence of the presumed fact, the presumed fact is disregarded when the party against whom the presumption operates introduces evidence which would support a finding of the nonexistence of the presumed fact and the existence of the fact otherwise presumed is then determined from the evidence in the same manner as if no presumption had been operable in the case.

Okla. Stat. Ann. tit. 15, §§ 151-177

§ 151. All contracts, public and private, interpreted by same rules

All contracts, whether public or private, are to be interpreted by the same rules, except as otherwise provided by law.

§ 152. Intent controls

A contract must be so interpreted as to give effect to the mutual intention of the parties, as it existed at the time of contracting, so far as the same is ascertainable and lawful.

§ 153. Intention ascertained, how

For the purpose of ascertaining the intention of the parties to a contract, if otherwise doubtful, the rules given in this chapter [1] are to be applied.

§ 154. Language governs

The language of a contract is to govern its interpretation, if the language is clear and explicit, and does not involve an absurdity.

§ 155. Intention ascertained from writing

When a contract is reduced to writing, the intention of the parties is to be ascertained from the writing alone, if possible, subject, however, to the other provisions of this article.[2]

§ 156. Real intention not expressed—Error to be disregarded

When through fraud, mistake, or accident, a written contract fails to express the real intention of the parties,

---

[1] R.L.1910, c. 12, now incorporated in this title and title 76.

[2] R.L.1910, c. 12, art. 3, now § 151 et seq. of this title.

such intention is to be regarded, and the erroneous parts of the writing disregarded.

§ 157. Effect given to every part

The whole of a contract is to be taken together, so as to give effect to every part, if reasonably practicable, each clause helping to interpret the others.

§ 158. Several contracts taken as one

Several contracts relating to the same matters, between the same parties, and made as parts of substantially one transaction, are to be taken together.

§ 159. Interpretation favors validity

A contract must receive such an interpretation as will make it lawful, operative, definite, reasonable and capable of being carried into effect, if it can be done without violating the intention of the parties.

§ 160. Words to be taken in ordinary sense—Exceptions

The words of a contract are to be understood in their ordinary and popular sense, rather than according to their strict legal meaning, unless used by the parties in a technical sense, or unless a special meaning is given to them by usage, in which case the latter must be followed.

§ 161. Technical words

Technical words are to be interpreted as usually understood by persons in the profession or business to which they relate, unless clearly used in a different sense.

§ 162. What law governs

A contract is to be interpreted according to the law and usage of the place where it is to be performed, or, if it does not indicate a place of performance, according to the law and usage of the place where it is made.

§ 163. Circumstances explain

A contract may be explained by reference to the circumstances under which it was made, and the matter to which it relates.

§ 164. Terms restricted to intention of parties

However broad may be the terms of a contract, it extends only to those things concerning which it appears that the parties intended to contract.

§ 165. Promisor's belief as to promisee's understanding governs in case of ambiguity

If the terms of a promise are in any respect ambiguous or uncertain, it must be interpreted in the sense in which the promisor believed, at the time of making it, that the promisee understood it.

§ 166. Part subordinate to whole

Particular clauses of a contract are subordinate to its general intent.

§ 167. Written and original parts control

Where a contract is partly written and partly printed, or where part of it is written or printed under the special directions of the parties, and with a special view to their intention, and the remainder is copied from a form originally prepared without special reference to the particular parties and particular contract in question the written parts control the printed parts, and the parts which are purely original control those which are copied from a form. And if the two are absolutely repugnant, the latter must be so far disregarded.

§ 168. Repugnancy—How reconciled

Repugnancy in a contract must be reconciled, if possible, by such an interpretation as will give some effect

to the repugnant clause, subordinate to the general intent and purposes of the whole contract.

§ 169. Inconsistent words rejected

Words in a contract which are wholly inconsistent with its nature, or with the main intention of the parties, are to be rejected.

§ 170. Interpretation against party causing uncertainty

In cases of uncertainty not removed by the preceding rules, the language of a contract should be interpreted most strongly against the party who caused the uncertainty to exist. The promisor is presumed to be such party, except in a contract between a public officer or body, as such, and a private party, in which it is presumed that all uncertainty was caused by the private party.

§ 171. Reasonable stipulations implied

Stipulations which are necessary to make a contract reasonable or conformable to usage, are implied in respect to matters concerning which the contract manifests no contrary intention.

§ 172. Necessary incidents implied, when

All things that in law or usage are considered as incidental to a contract, or as necessary to carry it into effect, are implied therefrom, unless some of them are expressly mentioned therein, when all other things of the same class are deemed to be excluded.

§ 173. Reasonable time allowed where not specified—Immediate performance

If no time is specified for the performance of an act required to be performed, a reasonable time is allowed. If the act is in its nature capable of being done instantly, as for example, if it consists in the payment of money

only, it must be performed immediately upon the thing to be done being exactly ascertained.

§ 174. Time not of essence unless so provided

Time is never considered as of the essence of a contract, unless by its terms expressly so provided.

§ 175. Promise presumed joint and several, when

Where all the parties who unite in a promise receive some benefit from the consideration, whether past or present, their promise is presumed to be joint and several.

§ 176. Promise of several in singular form

A promise made in the singular number, but executed by several persons, is presumed to be joint and several.

§ 177. Executed and executory contracts defined

An executed contract is one, the object of which is fully performed. All others are executory.

REGULATIONS OF THE FEDERAL ENERGY REGULATORY COMMISSION [1]

18 C.F.R. § 154.93 Rate schedule defined.

For the purpose of §§ 154.92 through 154.101 "rate schedule" shall mean the basic contract and all supplements or agreements amendatory thereof, effective and applicable on and after June 7, 1954, showing the service to be provided and the rates and charges, terms, conditions, classifications, practices, rules and regulations affecting or relating to such rates or charges, applicable to the transportation of natural gas in interstate commerce or the sale of natural gas in interstate commerce for resale subject to the jurisdiction of the Commission: *Provided,* That in contracts executed on or after April 3, 1961, for the sale or transportation of natural gas subject to the jurisdiction of the Commission, any provision for a change of price other than the following provisions shall be inoperative and of no effect at law; the permissible provisions for a change in price are:

(a) Provisions that change a price in order to reimburse the seller for all or any part of the changes in production, severance, or gathering taxes levied upon the seller;

(b) Provisions that change a price to a specific amount at a definite date;

(b-1) Provisions that permit a change in price to the applicable just and reasonable area ceiling rate which has been, or which may be, prescribed by the Commission for the quality of the gas involved; and

---

[1] The regulations provided herein, 18 C.F.R. §§ 154.93 and 270.205, were removed from the FERC's regulations. *Removal of Outdated Regulations Pertaining to the Sales of Natural Gas Production,* Order No. 567, III F.E.R.C. Stats. & Regs. (CCH) ¶ 30,999 (1994).

(c) Provisions that, once in five-year contract periods during which there is no provision for a change in price to a specific amount (paragraph (b) of this section), change a price at a definite date by a price-redetermination based upon and not higher than a producer rate or producer rates which are subject to the jurisdiction of the Commission, are not in issue in suspension or certificate proceedings, and, are in the area of the price in question: *Provided further,* That any contract executed on or after April 2, 1962, containing price-changing provisions other than the permissible provisions set forth in the proviso next above shall be rejected.

[Order 242, 27 FR 1357, Feb. 14, 1962, as amended by Order 329, 31 FR 15486, Dec. 8, 1966]

18 C.F.R. § 270.205 Contractual authorization to collect NGPA rates.

(a) *Existing interstate contracts.* In the case of an existing contract for a first sale of natural gas to which the Natural Gas Act applies:

(1) Any contractual provision for a change in price in such contract which by its terms specifically permits collection of NGPA rates or of maximum lawful prices prescribed by legislation, constitutes contractual authorization to charge and collect the NGPA rates applicable to such first sale.

(2) A contractual provision described in § 154.93 (b-1) (relating to area rate clauses), or similar provision, generally will be considered to constitute contractual authorization to charge and collect an NGPA rate to the extent the parties intended to authorize charging and collection of one or more NGPA rates under the contract.

* * * *

PROVISIONS FROM THE FEDERAL RULES OF EVIDENCE

Rule 301. Presumptions in General in Civil Actions and Proceedings

In all civil actions and proceedings not otherwise provided for by Act of Congress or by these rules, a presumption imposes on the party against whom it is directed the burden of going forward with evidence to rebut or meet the presumption, but does not shift to such party the burden of proof in the sense of the risk of nonpersuasion, which remains throughout the trial upon the party on whom it was originally cast.

Rule 302. Applicability of State Law in Civil Actions and Proceedings

In civil actions and proceedings, the effect of a presumption respecting a fact which is an element of a claim or defense as to which State law supplies the rule of decision is determined in accordance with State law.

APPENDIX E

GHK CONTRACT

* * * *

ARTICLE IV—REGULATION

4.1 This Agreement is subject to all present and future valid laws and lawful orders and regulations of all regulatory bodies now or hereafter having jurisdiction of the parties or either of them; and should either of the parties, by force of any such law, order or regulation, at any time during the term of this Agreement, be ordered or required to do any act inconsistent with the provisions of this Agreement, the Agreement shall continue nevertheless but shall then be deemed modified to conform with the requirements of such law, order or regulation for that period only during which the requirements of such law, order or regulation are applicable; provided, however, that this paragraph shall not be construed to limit the right of either party hereto to protest or seek to change any such law, order or regulation.

* * * *

ARTICLE X—PRICE

* * * *

10.3 If the Federal Power Commission, or any successor governmental authority having jurisdiction in the premises, shall at any time hereafter prescribe, for the area in which the contract acreage is located, a higher, applicable, just and reasonable area rate for the purchase of gas than the price herein provided to be paid, then the price to be paid by Buyer to Seller for gas delivered under the provisions of this Agreement shall be increased to equal such higher price effective as of the date such higher price is made applicable to the gas sold hereunder.

* * * *

SUN OIL COMPANY CONTRACT

* * * *

ARTICLE IV—REGULATION

4.1 This Agreement is subject to all present and future valid laws and lawful orders and regulations of all regulatory bodies now or hereafter having jurisdiction of the parties or either of them; and should either of the parties, by force of any such law, order or regulation, at any time during the term of this Agreement, be ordered or required to do any act inconsistent with the provisions of this Agreement, the Agreement shall continue nevertheless but shall then be deemed modified to conform with the requirements of such law, order or regulation for that period only during which the requirements of such law, order or regulation are applicable; provided, however, that this paragraph shall not be construed to limit the right of either party hereto to protest or seek to change any such law, order or regulation.

* * * *

ARTICLE X—PRICE

* * * *

10.3 If the Federal Power Commission, or any successor governmental authority having jurisdiction in the premises, shall at any time hereafter prescribe, for the area in which the contract acreage is located, a higher, applicable, just and reasonable area rate for the purchase of gas than the price herein provided to be paid, then the price to be paid by Buyer to Seller for gas delivered under the provisions of this Agreement shall be increased to equal such higher price effective as of the date such higher price is made applicable to the gas sold hereunder.

* * * *

AMERADA HESS CONTRACT

* * * *

ARTICLE IX—PRICE

* * * *

9.2 If the Federal Power Commission, or any successor governmental authority having jurisdiction over the sale of Gas hereunder, at any time hereafter prescribes or permits, by order following hearing, or by settlement, for the area in which the Gas Reserves are situated, an applicable higher price for the sale of Gas than the price being paid hereunder at the time, then the price for Gas delivered hereunder will be increased effective as of the date such higher price is prescribed or permitted to equal such higher price.

* * * *

ARTICLE XVI—REGULATION

16.1 This Agreement is subject to all present and future valid laws and lawful orders and regulations of all regulatory bodies now or hereafter having jurisdiction of the parties or either of them; and should either of the parties, by force of any such law, order or regulation, at any time during the term of this Agreement, be ordered or required to do any act inconsistent with the provisions of this Agreement, the Agreement will continue nevertheless but shall then be deemed modified to conform with the requirements of such law, order or regulation for that period only during which the requirements of such law, order or regulation are applicable.

* * * *

OKLAHOMA UNIFORM JURY INSTRUCTIONS

CIVIL

(SECOND EDITION)

Prepared by the

Oklahoma Supreme Court Committee for Uniform Civil Jury Instructions

OKLAHOMA SUPREME COURT COMMITTEE FOR UNIFORM CIVIL JURY INSTRUCTIONS

CHAIR

THE HONORABLE ROBERT A. LAYDEN
District Judge
McAlester

REPORTER

CHARLES W. ADAMS
Professor of Law
The University of Tulsa College of Law

LIAISON MEMBERS

THE HONORABLE MARIAN P. OPALA
Justice, Oklahoma Supreme Court

THE HONORABLE HARDY SUMMERS
Justice, Oklahoma Supreme Court

THE HONORABLE DANIEL J. BOUDREAU
Judge, Oklahoma Court of Appeals

MEMBERS

THE HONORABLE STEVEN ADAMS
District Judge
Claremore

MARK A. ASHTON
Lawton

HOWARD K. BERRY, JR.
Oklahoma City

MIKE BURRAGE
Antlers

GEORGE D. DAVIS
Oklahoma City

THE HONORABLE JACQUELINE DUNCAN
Special Judge
Arapaho

EMMANUEL E. EDEM
Oklahoma City

JAMES E. FRASIER
Tulsa

JIMMY GOODMAN
Oklahoma City

THE HONORABLE GARY L. LUMPKIN
Judge, Oklahoma Court of
Criminal Appeals
Oklahoma City

E. BAY MITCHELL, III
Oklahoma City

THE HONORABLE JACK PARR
Retired District Judge
Oklahoma City

DALE RENEAU
Oklahoma City

RONALD N. RICKETTS
Tulsa

JEFFERSON D. SELLERS
Sapulpa

JOSEPH A. SHARP
Tulsa

HAVEN TOBIAS
Oklahoma City

THOMAS A. WALLACE
Oklahoma City

TERRY W. WEST
Shawnee

[Filed Feb. 26, 1993]

IN THE SUPREME COURT
OF THE STATE OF OKLAHOMA

SCAD—93-3

Re: OKLAHOMA UNIFORM CIVIL JURY INSTRUCTIONS

The Oklahoma Supreme Court Committee for Uniform Civil Jury Instructions has completed a revision of the Oklahoma Uniform Civil Jury Instructions which is attached to this Order. To achieve uniformity in instructing juries in civil cases on the applicable law, the following order is adopted for the direction of the trial courts:

IT IS ORDERED THAT effective August 2, 1993, all trial courts in Oklahoma shall use the instructions contained within the Oklahoma Uniform Jury Instructions—Civil (Second Edition) if the court determines that the subject of the instructions would be appropriate in the particular matter on trial and unless the trial court determines that such recommended instruction does not accurately state the law. In the latter event, it shall be the obligation of the trial court to include within the record the court's reasons for declining to use the recommended uniform instruction. However, by this order the Court is not relinquishing any of its constitutional or statutory authority of review.

IT IS FURTHER ORDERED THAT whenever the Oklahoma Uniform Jury Instructions—Civil (Second Edition) does not contain an instruction on a subject which the trial court determines should be submitted to the jury or whenever a recommended uniform instruction cannot be modified to cover the subject being submitted, it shall then be the duty of the trial court to submit that subject to the jury upon an instruction which will be simple, brief, impartial and free from argument.

Each instruction shall be identified substantially as follows:

"OUJI-Civ. No. ——" or "OUJI-Civ. No. —— modified" or "Not in OUJI-Civ." as the case may be. ADOPTED IN CONFERENCE this 25th day of February, 1993.

/s/ Ralph B. Hodges
Chief Justice

INTRODUCTORY NOTE ON USE OF INSTRUCTIONS

The Committee for Uniform Jury Instructions (the "Committee") has separated these instructions into Chapters and has assigned a number and title for convenience. Whether the titles should be read to the jury along with the text of the instructions is a matter that is best left to the discretion of the trial judge. Including the titles in the charge to the jury may help to focus the attention of the jurors on the key parts of the instructions. On the other hand, the use of the titles may break up the steady flow of the instructions and convey the impression that they are not to be considered as a whole.

Another matter that the Committee believes to be within the discretion of the trial judge is whether to provide jurors with individual copies of the jury instructions immediately before delivering the charge. The Committee believes that permitting jurors to read the instructions at the time of the charge would improve comprehension, and therefore it recommends this procedure. The Committee also recommends providing jurors with a copy (or individual copies) of the instructions during deliberations.

If a party asserts a claim or a defense that is supported by the evidence but not covered by these instructions, the trial judge should prepare an instruction that accurately states the law applicable to the claim or defense. The instructions in this book should be modified where appropriate to fit the facts and circumstances of the particular case. In preparing additional instructions or when modifying a recommended instruction, the trial judge should prepare an instruction which is simple, brief, impartial, and free from argument.

* * * *

Instruction No. 3.1

BURDEN OF PROOF—GREATER WEIGHT OF THE EVIDENCE

In a civil lawsuit, such as this one, the law provides which party is to prove certain things to you. This is called "Burden of Proof."

When I say that a party has the burden of proof on any proposition by the greater weight of the evidence, or use the expression "if you find," or "if you decide," I mean you must be persuaded, considering all the evidence in the case, that the proposition on which such party has the burden of proof is more probably true than not true. The greater weight of the evidence does not mean the greater number of witnesses testifying to a fact, but means what seems to you more convincing and more probably true.

A party who seeks to recover on a claim [or counterclaim], or a party who raises an affirmative defense has the burden to prove all the elements of the claim or defense. In deciding whether a party has met the burden of proof, you are to take into account all the evidence, whether offered by that part or any other party.

Notes on Use

It will generally be appropriate for the substantive instruction to also specify which party has the burden of proof. See e.g., Instruction Nos. 9.1, 12.1.

Comments

This instruction uses "greater weight of the evidence" instead of "preponderance of the evidence" to make the instruction more understandable to jurors. The words have the same meaning, and no change is intended in the standard of proof for civil cases. *See Henderson v. State*, 568 P.2d 297, 298 (Okla. Crim. App. 1982) ("A pre-

ponderance of the evidence has been defined by this Court to mean simply the greater weight of evidence."); Black's Law Dictionary 1182 (6th ed. 1990).

* * * *

Instruction No. 3.4

PRESUMPTION—DEFINED—USE

Presumptions are rules based upon experience or public policy and are established in the law to assist a jury in discovering the truth. Presumptions take the place of evidence unless and until outweighed by evidence to the contrary.

In this case, the law presumes that [insert a description of the presumption].

If you find that [insert a description of the basic fact], then the burden of proof is upon the [party against whom the presumption operates] to prove that [insert description of non-existence of the presumed fact] is more probably true than not true.

Notes on Use

This Instruction should not be given unless a basic fact has probative value of the existence of the presumed fact. No instruction on presumptions should be given unless the burden of proof shifts under the statute.

Comments

12 O.S.1991, §§ 2302, 2303.

Instruction No. 3.5

PRESUMPTION OF KNOWLEDGE BASED ON DUTY TO INQUIRE

NO INSTRUCTION SHOULD BE GIVEN

Notes on Use

Instruction 3.4, "Presumption—Defined—Use," appropriately covers this issue.

PART TWO—INTERPRETATION

Instruction No. 23.11

INTERPRETATION OF CONTRACTS—IN GENERAL

In this case, you will need to decide the meaning of the following term of the contract: [quote the term whose meaning is in dispute to the jury]. To do this you must decide what the intent of the parties was when they made their contract.

To decide what their intent was you should first examine the language of the contract. You may also consider the circumstances under which the parties made the contract, and what the parties themselves believed the term meant as shown by the evidence.

A contract should be interpreted so that it is [lawful,] reasonable and capable of being carried out, if this can be done without changing the intention of the parties.

Notes on Use

This Instruction should not be given unless there is a jury question as to the contract's meaning. In order to focus the jury's attention on the language whose meaning is in dispute, the trial court should quote the language from the contract in the first sentence. The bracketed word "lawful" should not be included, unless one party urges an interpretation of the contract that would make it unlawful. If it is included, the court should also instruct the jury on which interpretation is unlawful.

Comments

The interpretation of a contract should not be presented to the jury unless the court determines that the contractual language is ambiguous. *See Corbett v. Combined Communications Corp. of Okla., Inc.*, 654 P.2d 616, 617

(Okla. 1982) ("If the language of a contract is clear and without ambiguity, the Court is to interpret it as a matter of law. [Citation omitted.]. Similarly, the existence of an ambiguity is a decision to be made by the Court."); *Walker v. Telex Corp.*, 583 P.2d 482, 485 (Okla. 1978) ("The construction of an unambiguous contract is a matter of law for the court. [Citation omitted.]. If an ambiguity arises by reason of the language used and not because of extrinsic facts, construction of the contract remains a question of law for the court.").

The second sentence of the first paragraph is derived from 15 O.S.1991 § 152, which provides: "A contract must be so interpreted as to give effect to the mutual intention of the parties, as it existed at the time of contracting, so far as the same is ascertainable and lawful."

The first sentence of the second paragraph is based on 15 O.S.1991 § 154, which provides: "The language of a contract is to govern its interpretation, if the language is clear and explicit, and does not involve an absurdity. *See also Mercury Inv. Co. v. F.W. Woolworth Co.*, 706 P.2d 523, 529 (Okla. 1985) ("[*W*]*here a contract is complete in itself and, as viewed in its entirety, is unambiguous, its language is the only legitimate evidence of what the parties intended.*") (emphasis in original). Although interpretation is not a jury question if a contract's language is unambiguous, the first sentence is included in the Instruction in order to make plain to the jury that the language of the contract is the primary determinant of its meaning. Besides the language the jury should also consider the surrounding circumstances and the actions of the parties. *See* 15 O.S.1991 § 163 ("A contract may be explained by reference to the circumstances under which it was made, and the matter to which it relates."); *Farmer v. Trepp*, 376 P.2d 596, 598 (Okla. 1962) ("It is settled law in this jurisdiction that the practical construction placed upon an ambiguous agreement by interested parties will be given great if not controlling

weight."); *Gillham v. Jenkins,* 244 P.2d 291, 294 (Okla. 1952) ("In the interpretation of a contract the mutual intention of the parties as it existed at the time of the contract is a paramount objective. The circumstances under which the contract was made and the subsequent acts and conduct of the parties may be considered in arriving at the intention.").

The last paragraph is based on 15 O.S.1991 § 159, which provides: "A contract must receive such an interpretation as will make it lawful, operative, definite, reasonable and capable of being carried into effect, if it can be done without violating the intention of the parties."

Supreme Court, U.S.
FILED
NOV 3 1995
OFFICE OF THE CLERK

No. 95-554

(2)

In the Supreme Court of the United States

OCTOBER TERM, 1995

ROBERT W. SCARTH, *et al.*, PETITIONERS

v.

NICOR EXPLORATION COMPANY, RESPONDENT

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF IN OPPOSITION

ROY T. ENGLERT, JR.
Mayer, Brown & Platt
2000 Pennsylvania Ave., N.W.
Washington, D.C. 20006

H. BRUCE GOLDEN
Counsel of Record
Golden & Associates, P.C.
4500 NationsBank Center
Houston, TX 77002
(713) 223-2600

J. BRENT GARFIELD
Nicor Oil & Gas Corporation
1050 Seventeenth Street
Suite 1280
Denver, CO 80265

Counsel for Respondent

BEST AVAILABLE COPY

2700

QUESTIONS PRESENTED

1. Whether, in light of petitioner's explicit concession that "[i]f contract interpretation were the only issue NICOR had raised[ ] *de novo* review might be the exclusive standard," and petitioner's failure to advocate any other standard of review for issues of contract interpretation, the court of appeals correctly applied a *de novo* standard of review to contract interpretation issues, rather than deferring to FERC's resolution of those issues.

2. Whether the court of appeals misapplied the substantial evidence standard to the facts of this case.

3. Whether the court of appeals misapplied state law to this case.

4. Whether the court of appeals, having concluded that FERC's own factual findings compelled judgment for NICOR as a matter of law, should have remanded this case for the pointless exercise of allowing FERC in the first instance to apply the correct legal standards, or instead rightly directed the entry of judgment for NICOR.

RULE 29.6 STATEMENT

Respondent NICOR Exploration Company no longer exists; its name was changed to SCANA Exploration Company effective June 23, 1993. Effective December 29, 1993, SCANA Exploration Company was merged into SCANA Petroleum Resources Inc., whose parent is SCANA Corporation. Before that, NICOR Exploration Company was a wholly owned subsidiary of NICOR Exploration and Production Company, which in turn was wholly owned by NICOR Oil and Gas Corporation, a wholly owned subsidiary of NICOR Inc. At all those times, NICOR Exploration Company had no non-wholly-owned subsidiaries.

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

RULE 29.6 STATEMENT ii

TABLE OF AUTHORITIES iv

STATEMENT 1

ARGUMENT 11

CONCLUSION 19

TABLE OF AUTHORITIES

Page

CASES

AFGE v. *FLRA*, 786 F.2d 554 (2d Cir. 1986) 18

Amoco Production Co. v. *FERC*, 765 F.2d 686 (7th Cir. 1985) 12

Associated Gas Distributors v. *FERC*, 810 F.2d 226 (D.C. Cir. 1987) 13

Bowen v. *Georgetown University Hospital*, 488 U.S. 204 (1988) 15

Butner v. *United States*, 440 U.S. 48 (1979) 17

Chevron U.S.A. Inc. v. *NRDC*, 467 U.S. 837 (1984) 9-11, 13

Consolidated Gas Supply Corp. v. *FERC*, 745 F.2d 281 (4th Cir. 1984), cert. denied, 472 U.S. 1008 (1985) 11

Cort v. *Ash*, 422 U.S. 66 (1975) 17

Delta Airlines, Inc. v. *August*, 450 U.S. 346 (1981) 11

Diamond Ring Ranch, Inc. v. *Morton*, 531 F.2d 1397 (10th Cir. 1976) 18

El Paso Natural Gas Co. v. *FERC*, 881 F.2d 161 (5th Cir. 1989) 12

FPC v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956) 5

Haring v. *Prosise*, 462 U.S. 306 (1983) 17

TABLE OF AUTHORITIES — Continued

Page

Hunt Oil Co. v. *FERC*, 853 F.2d 1226 (5th Cir. 1988) 9, 18

Mobil Oil Exploration & Producing Southeast Inc. v. *United Distribution Cos.*, 498 U.S. 211 (1991) 9

National Fuel Gas Supply Corp. v. *FERC*, 811 F.2d 1563 (D.C. Cir.), cert. denied, 484 U.S. 869 (1987) 11-13, 15

Natural Gas Clearinghouse v. *FERC*, 965 F.2d 1066 (D.C. Cir. 1992) 12

NLRB v. *Hendricks County Rural Electric Membership Corp.*, 454 U.S. 170 (1981) 16

Northwest Pipeline Corp. v. *FERC*, 61 F.3d 1479 (10th Cir. 1995) 12, 14

Pacific Gas & Electric Co. v. *FERC*, 746 F.2d 1383 (9th Cir. 1984) 12

Pennzoil Co. v. *FERC*, 645 F.2d 360 (5th Cir. 1981), cert. denied, 454 U.S. 1142 (1982) . . . . . *passim*

Pennzoil Co. v. *FERC*, 645 F.2d 394 (5th Cir. 1981) 7

Pennzoil Co. v. *FERC*, 789 F.2d 1128 (5th Cir. 1986) 6, 9, 15

Permian Basin Area Rate Cases, 390 U.S. 747 (1968) 4

Rivera v. *Sullivan*, 923 F.2d 964 (2d Cir. 1991) 18

TABLE OF AUTHORITIES — Continued

Page

Rudolph v. *United States*, 370 U.S. 269 (1962) 16

Sisson v. *Ruby*, 497 U.S. 358 (1990) 11

South Dakota Public Utilities Commission v. *FERC*, 934 F.2d 346 (D.C. Cir. 1991), cert. denied, 112 S. Ct. 1244 (1992) 13

Transwestern Pipeline Co. v. *FERC*, 988 F.2d 169 (D.C. Cir. 1993) 14

United Gas Pipe Line Co. v. *Memphis Light, Gas & Water Division*, 358 U.S. 103 (1958) 5

United Gas Pipe Line Co. v. *Mobil Gas Service Corp.*, 350 U.S. 332 (1956) 5

Volt Information Sciences, Inc. v. *Board of Trustees*, 489 U.S. 468 (1989) 17

Williams National Gas Co. v. *FERC*, 3 F.3d 1544 (D.C. Cir. 1993) 13, 14

STATUTES

Natural Gas Act of 1938, 15 U.S.C. § 717, *et seq.* 14

Natural Gas Policy Act of 1978:

§ 101(b)(9), 15 U.S.C. § 3311(b)(9) 5

§ 104, 15 U.S.C. § 3314 4

§ 108, 15 U.S.C. § 3318 . . . . . *passim*

§ 601(b)(1)(A), 15 U.S.C. § 3431(b)(1)(A) 2

TABLE OF AUTHORITIES — Continued

Page

MISCELLANEOUS

5A Corbin on Contracts (1964) 10

Opinion No. 77, 10 FERC ¶ 61,214 (1980) . . . 7, 8, 17

Opinion No. 586, 44 FPC 761 (Sept. 18, 1970) 4

Order No. 23, 6 FERC (CCH) ¶ 61,229 (Mar. 13, 1979) 7

R. STERN, E. GRESSMAN, S. SHAPIRO & K. GELLER, SUPREME COURT PRACTICE (7th ed. 1993) . . . 16, 17

BRIEF IN OPPOSITION

The Federal Energy Regulatory Commission (FERC), whose order was overturned in the decision below, has not sought review in this Court. But petitioner Robert W. Scarth, an intervenor below, asks this Court to grant certiorari in order to reverse the Fifth Circuit on a ground that petitioner never urged below, to review the routine application of the substantial evidence test, to review the routine application of state law, and to require the Fifth Circuit to engage in the pointless exercise of remanding to the agency a case that can have only one possible outcome. In no respect has petitioner justified – indeed, in most instances petitioner has made no effort to justify – the exercise of this Court's discretionary certiorari jurisdiction. Instead, petitioner for the most part simply argues the merits of issues that he lost in the court of appeals. Not only are the issues that petitioner raises uncertworthy; they also were resolved correctly by the court of appeals.

STATEMENT

NICOR Exploration Company (NICOR) challenged petitioner's authority, under the "area rate clauses" (ARCs) of particular contracts, to charge NICOR incentive prices under stripper-well provisions of Section 108 of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. § 3318. After a six-day hearing, an administrative law judge (ALJ) agreed with NICOR, concluding that NICOR and petitioner's predecessors did not mutually intend to permit collection of the incentive price. Pet. App. 15a-31a. FERC affirmed (Pet. App. 32a-53a), concluding that the ALJ's "Initial Decision is amply supported in the record and is fully consistent with applicable Commission and judicial precedent." Pet. App. 33a. On rehearing, however, FERC completely reversed the outcome. Pet. App. 54a-75a, 76a-99a. It rejected both the ALJ's and its own prior determinations, and held that petitioner was authorized to collect NGPA Section 108 prices.

The Fifth Circuit reversed (Pet. App. 1a-14a), holding that "the Commission failed to properly apply state contract law in construing the area rate clauses and that, under state law, Scarth failed to satisfy his burden of proof" (*id.* at 2a). Consistent with the standard of review urged on it by petitioner (Scarth C.A. Br. 27-28, *reprinted in* App., *infra*, 1a), the court of appeals accepted *all* of FERC's factual findings but applied *de novo* review to its legal determinations concerning the interpretation of the contracts under Oklahoma law. Because FERC *itself* determined, both initially and on rehearing (Pet. App. 51a, 61a-64a, 82a), that petitioner did not prove by a preponderance of the evidence that the contract language and extrinsic evidence supported his interpretation, FERC's own findings mandated judgment for NICOR as a matter of law, and the court of appeals remanded with directions to enter such a judgment. Pet. App. 2a, 14a.

1. In 1970, petitioner's predecessors – GHK, Sun, and Amerada Hess – agreed to sell their respective portions of production from the Green #1-1 Well (Green Well) in Oklahoma to NICOR's predecessor, NI-Gas Supply, Inc., which acted as the contracting arm for its corporate parent, Northern Illinois Gas Company (NI-Gas), a local distribution company (LDC). Pet. App. 33a. At that time, natural gas sales in interstate commerce typically were effected through the purchase, transportation, and resale of gas by interstate pipelines, not LDCs. Section 601(b)(1)(A) of the NGPA, 15 U.S.C. § 3431(b)(1)(A), guarantees to interstate pipelines the ability to pass through NGPA payments for gas, whether or not those payments are cost based. *Pennzoil Co.* v. *FERC*, 645 F.2d 360, 379 n.38 (5th Cir. 1981) (*Pennzoil I*), cert. denied, 454 U.S. 1142 (1982). By contrast, NI-Gas as an LDC was not entitled to an automatic pass-through of its payments; the Illinois Commerce Commission might not permit NI-Gas to recover excessive gas acquisition costs from its customers. Ex. 7 at 2.

After GHK began negotiations with NI-Gas for the sale of production from the Green Well, GHK farmed out fractions of its working interest in the Green Well to Sun and Amerada. Ex. 21 at 3. Dan Parson and Robert Maurath, who reported to Parson, handled negotiations with all three producers for NI-Gas. Ex. 4 at 3-4; Tr. 344.

NI-Gas's negotiators emphasized that it could agree to pay only cost-justified rates. Ex. 7 at 2. The parties therefore negotiated for other economic considerations. For example, Robert Hefner, GHK's chairman, "felt GHK was stuck with low area rates." Ex. 21.

The initial contract price under the GHK, Sun, and Amerada contracts was 21¢ per Mcf. The ARCs in the Sun and GHK contracts are worded identically, and it is unclear who drafted the language. Tr. 276-277, 364, 392, 455; Ex. 102. They provide (Pet. App. 2a-3a, 71a):

> If the Federal Power Commission, or any successor governmental authority having jurisdiction in the premises, shall at any time hereafter prescribe, for the area in which the contract is located, a higher, applicable, just and reasonable area rate for the purchase of gas than the price herein provided to be paid, then the price to be paid by the Buyer to Seller for gas delivered under the provisions of this Agreement shall be increased to equal such higher price effective as of the date such higher price is made applicable to the gas sold hereunder.

The slightly different language of the Amerada contract was provided by Amerada as its "preferred language for an area rate clause." Ex. 30 at 4; Ex. 90 at 7; Tr. 297, 364, 845-846. "The only substantive difference is that the area rate clause in the Amerada Hess contract omits the phrase 'just and reasonable.'" Pet. App. 3a n.1.

2. Shortly after NICOR began purchasing gas from the Green Well, FERC's predecessor (the Federal Power Commission or FPC) established an "area rate" covering the Green Well. Opinion No. 586, 44 FPC 761 (Sept. 18, 1970). "Area rates" are maximum prices set for an entire major producing area, and were at the relevant time a major innovation in natural gas regulation. See *Permian Basin Area Rate Cases*, 390 U.S. 747, 758 (1968). "Area rates" are necessarily *cost-based* rates. *See id.* at 761.

In late 1974 and early 1975, while NICOR was paying the established "area rate," GHK, Sun, and Amerada sought an amendment of the pricing provisions of the contracts to provide for a higher price for the gas. Exs. 31, 32. NICOR wrote GHK, Sun, and Amerada and stated that, if the *cost* of the proposed work-over was "substantially higher" than anticipated, NICOR would not oppose a request to the FPC for approval of a higher price and that NICOR "would agree to pay the increased price which is approved by the FPC." Ex. 33; see also Tr. 476. In view of NICOR's unwillingness to increase the contract price of gas from the Green Well based on non-cost factors, the proposed work-over did not proceed.

After enactment of the NGPA in 1978, NICOR began paying prices calculated under NGPA § 104, 15 U.S.C. § 3314. As the Fifth Circuit has noted, Section 104 prices are "based and inextricably linked to" previously prescribed FPC rates and simply carry forward the cost-based methodology the FPC employed in its rate proceedings. *Pennzoil I*, 645 F.2d at 380 n.39. On March 7, 1980, following enactment of the NGPA, Sun asked NICOR to amend its gas purchase contract for the Green Well to provide for "NGPA pricing." Ex. 111; Tr. 938-939. NICOR did not agree to that proposed amendment. Pet. App. 50a.

Petitioner acquired the interests in the Green Well formerly held by GHK, Amerada, and Sun in 1988 and 1989. Ex. 64. Before his acquisition of those interests, petitioner had

no relationship to the Green Well or any of the contract negotiations.

As an incentive to continue production from low-output wells, Section 108 of the NGPA provides for "stripper well" prices that are much higher than Section 104 prices, "area rates," or any other *cost-based* prices. But Section 108 prices can be charged only if the *contract*, as well as the statute, permits them.[1] Neither Sun nor Amerada ever applied for stripper classification of the well or sought stripper pricing from NICOR under Section 108. *E.g.*, Tr. 728. Petitioner, however, filed an application for Section 108 classification immediately after he began acquiring GHK's working interest. Ex. 74. Petitioner then undertook a work-over of the well and filed an application for enhanced-recovery Section 108 status. Petitioner's actions here are characteristic of his general business practice of locating older producing properties subject to contracts containing ARCs, purchasing those contract rights, and later seeking to collect NGPA § 108 prices that were not being claimed by the original sellers. Ex. 53 at 2-3; Tr. 642, 647-648. Petitioner sought to collect prices of $6.66/MMBtu, compared to market prices of approximately $1.25/MMBtu.

3. The ALJ concluded "that the ARCs in question contemplated payment and collection of only cost-based prices." Pet. App. 31a. The ALJ found (*id.* at 25a):

---

[1] NGPA § 101(b)(9), 15 U.S.C. § 3311(b)(9); *United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Division*, 358 U.S. 103 (1958); *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956); *United Gas Pipe Line Co.* v. *Mobil Gas Service Corp.*, 350 U.S. 332 (1956). Under the *Mobil-Sierra* doctrine, contractual authority is necessary for a seller to collect incentive prices under the NGPA, and a court on judicial review must determine whether the ARCs in question authorize collection of the maximum incentive pricing category established by NGPA § 108. *Pennzoil I*, 645 F.2d at 380-381.

> There is no substantive or material evidence in this case to substantiate Scarth's claim that NICOR did not intend to have the area rate clause include only cost-justified rates. On the contrary, the testimony of NICOR's witnesses, Parson, Maurath and Hefner, supports the contrary conclusion, that NICOR intended to pay only cost-justified rates and that the area rate clauses were intended to include only such rates.

After a "careful review of the record," the Commission held that the ALJ's "Initial Decision is amply supported in the record and is fully consistent with applicable Commission and judicial precedent." Pet. App. 32a-33a. In so holding, the Commission recognized its obligation to follow the Fifth Circuit's *Pennzoil* decisions. *Id.* at 35a n.2 (citing *Pennzoil I, supra*, and *Pennzoil Co.* v. *FERC*, 789 F.2d 1128 (5th Cir. 1986) (*Pennzoil II*)). The Commission found that NICOR had proven mutual intent under the GHK contract, and that the parties' "mutual intent * * * was that only cost-based rates were intended." *Id.* at 51a. The Commission also accepted as proven fact the proposition that "NICOR envisioned only cost-based rates." *Ibid.* Although those two conclusions were sufficient to end the case, the Commission went on to analyze the language of the ARCs and determined that it, too, supported NICOR's position. *Id.* at 51a-53a.

In granting rehearing and reversing its disposition of NICOR's protest, FERC *adhered* to its prior determination that petitioner had not shown a *mutual* intent to allow incentive rates (Pet. App. 63a-64a), specifically *rejecting* an invitation by petitioner to "go further and find that a preponderance of the evidence shows that NICOR intended to pay incentive rates under all three of the Green contracts" (*id.* at 61a-62a), because it continued to believe that "NICOR witnesses Parson and Maurath were credible" (*id.* at 63a). FERC abandoned its prior determination that NICOR had succeeded in showing mutual intent under the GHK contract (*id.* at 58a-

61a), but remained of the view that petitioner had not shown a contrary mutual intent.

FERC did not stop with a determination that petitioner had failed to meet his burden of proof, however. FERC invoked a "two-step process," foreign to the contract law of any State, under which a failure of proof on mutual intent leads the Commission to discard *all* extrinsic evidence and "decide the matter *solely* by reviewing the express terms of the area rate clause pursuant to interpretative standards established in [FERC] Opinion No. 77." Pet. App. 56a (emphasis added).[2]

---

[2] Opinion No. 77, 10 FERC ¶ 61,214 (1980), is a refinement of procedures set out in FERC Order No. 23, 6 FERC (CCH) ¶ 61,229 (Mar. 13, 1979). Unlike the Order No. 23 procedures, which were adopted by rulemaking and then generally upheld in *Pennzoil I*, the Opinion No. 77 standards had never been judicially reviewed until this case. A challenge to Opinion No. 77 was dismissed without prejudice as unripe in *Pennzoil Co.* v. *FERC*, 645 F.2d 394 (5th Cir. 1981), which was simultaneous with (but not the same as) *Pennzoil I*. Opinion No. 77 provides in pertinent part:

> we will generally conclude that a contract containing an area or national rate clause does not authorize collection of all NGPA rates if it contains the following disqualifying terms:
>
> (1) It refers to rates established or prescribed by an administrative body;
>
> (2) It couples the reference to administrative action with a reference to the Natural Gas Act or the "just and reasonable" standard of that Act; and
>
> (3) It contains no additional language which has the effect of uncoupling the link between agency action and the statutory standard of the Natural Gas Act.

10 FERC at 61,398.

As to the express terms of the ARCs, FERC did not dispute its own prior determination (Pet. App. 52a) that "the most logical, most obvious, most natural and most reasonable interpretation of the * * * language" of the Amerada Hess clause is that it allows only cost-based rates. Rather, FERC held that it was *disabled* by its own precedent from accepting even the most powerful inference from contractual text, because "Opinion No. 77 requires that the required words appear on the face of the area rate clause." Pet. App. 70a-71a; see also Pet. App. 95a (absence of "the express wording required by prong two" of Opinion No. 77 is dispositive). Turning to the Sun and GHK contracts, FERC held that "there is nothing in the context of subject clauses that *can clearly* be read as excluding rates set by Congress or in any way limiting the scope of authority exclusively to rates set by an administrative body." Pet. App. 74a (emphasis added).

NICOR's application for rehearing stressed, among other arguments, that petitioner's failure to prove mutual intent was decisive and, standing alone, required a ruling in NICOR's favor. In response, the Commission reaffirmed that petitioner had not proved a mutual intent to contract for incentive-based rates. Pet. App. 82a ("here, neither of the parties could prove a mutual intent by extrinsic evidence"). Nevertheless, the Commission maintained that it was entitled to apply the Opinion No. 77 "interpretive standards" to rule in petitioner's favor. *Id.* at 92a-99a.

4. On judicial review, NICOR renewed its argument that, even if all of FERC's factual findings are accepted, NICOR is entitled to judgment as a matter of law because FERC itself *rejected*, in *each* of its orders, petitioner's position that he had met his burden of proof. NICOR freely acknowledged that FERC's factual findings are reviewed under the substantial evidence standard (albeit with extra scrutiny because the agency disagreed with the ALJ who heard the witnesses) and that FERC's construction of a statute it is charged with administering would receive "*Chevron* defer-

ence."[3] NICOR C.A. Br. 15-16 & n.7; NICOR C.A. Reply Br. 3-6. As to issues of *contract interpretation* raised by ARCs, however, NICOR pointed to an unbroken line of Fifth Circuit precedent requiring *de novo* review because FERC's jurisdiction in ARC cases is merely concurrent, not exclusive, and because the issues turn *not* on FERC's special expertise or delegated policymaking function, but on the interpretation of state law. *E.g.*, *Pennzoil I*; *Pennzoil II*; *Hunt Oil Co.* v. *FERC*, 853 F.2d 1226, 1235 (5th Cir. 1988).

Petitioner did not disagree with NICOR as to the applicable standard of review. The standard-of-review discussion in petitioner's brief – which is reprinted *in its entirety* in an appendix to this brief in opposition – was confined to a concession that *de novo* review applied insofar as the case involved legal issues of contract interpretation, and a series of mischaracterizations of NICOR's position concerning review of factual findings. See App., *infra*, 1a.[4] Petitioner con-

---

[3] *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837 (1984); see also *Mobil Oil Exploration & Producing Southeast Inc.* v. *United Distribution Cos.*, 498 U.S. 211, 225 n.5 (1991).

[4] Specifically, petitioner insisted that "NICOR * * * maintains that FERC was wrong in its factual finding that the extrinsic evidence which NICOR had presented was inconclusive." App., *infra*, 1a. Although NICOR indeed believed it presented conclusive evidence of the parties' mutual intent that only cost-based rates would be charged, the main thrust of NICOR's brief was *not* that argument, but instead the logically prior argument – with which the Fifth Circuit would ultimately agree – that FERC's own findings compelled judgment for NICOR as a matter of law, because FERC itself determined that petitioner failed in his burden of proof. Given petitioner's failure to meet *his* burden of proof, it simply was not relevant whether NICOR had proved the opposite of what petitioner failed to prove. Thus, the Fifth Circuit never reached any issues concerning application of the substantial evidence standard. Nevertheless, petitioner here mischaracterizes the Fifth Circuit's decision (see Pet. 13-25) much the same way that he mischaracterized NICOR's position below.

fessed, in particular, that "[i]f contract interpretation were the only issue NICOR had raised[ ] *de novo* review might be the exclusive standard." *Ibid.* Petitioner did not cite *Chevron* or any other case applying the principles of *Chevron*; in particular, petitioner did not cite a single one of the D.C., Fourth, Seventh, and Tenth Circuit decisions that now form the centerpiece of his certiorari petition (Pet. 9-12). Nor did FERC cite any of those cases. See FERC C.A. Br. 19-21.

Applying *de novo* review (Pet. App. 10a), but without questioning any of FERC's factual findings, the Fifth Circuit reversed because FERC misapplied *state law*. Pet. App. 1a-14a. In particular, FERC threw out all of the "inconclusive" extrinsic evidence and based its holding solely on isolated phrases in the ARCs "without considering the language of the area rate clauses as a whole" (*id.* at 12a), all in contravention of applicable Oklahoma law. Furthermore,

> The ALJ concluded that Scarth failed to satisfy his burden of proof with regard to the extrinsic evidence of intent. Although the Commission accepted this finding, it applied Opinion 77's three-part formula because NICOR failed to prove that the parties mutually intended to limit rate increases to cost-based rates * * *.
>
> * * * Scarth's failure to prove by a preponderance of the extrinsic evidence that the parties mutually intended to allow non-cost-based rates would have resulted in a judgment in favor of NICOR in Oklahoma state court. *See* 5A Corbin on Contracts § 1230 at 511 (1964).

Pet. App. 12a-13a. Because "Scarth * * * failed to meet his burden of proof under Oklahoma contract law and *Pennzoil I*," Pet. App. 14a, the court remanded with directions to enter judgment for NICOR.

5. Petitioner sought rehearing and rehearing en banc in the court of appeals, but FERC did not. Instead, after the court of appeals (without dissent or even a call for a vote) denied

Scarth's petitions, Pet. App. 100a, FERC on September 19, 1995, denied petitioner's request for an increase in rates to NGPA § 108 incentive prices and ordered petitioner to refund to NICOR the excess over the applicable ceiling price that petitioner had collected from NICOR.

ARGUMENT

1. Petitioner first (Pet. 9-13) argues that this Court should grant certiorari to decide whether FERC's interpretation of a contract receives *Chevron* deference. Petitioner, however, never urged below the position that he urges here and therefore is foreclosed from making that argument. See, *e.g.*, *Sisson* v. *Ruby*, 497 U.S. 358, 359 n.1 (1990); *Delta Airlines, Inc.* v. *August*, 450 U.S. 346, 362 (1981). Furthermore, FERC – the party that might more appropriately raise this issue in a proper case – has not itself petitioned for certiorari. And, notwithstanding the cases petitioner cites, it is clear that *no* court would give deference to FERC's vacillating construction of the contracts at issue in this case.

In a case involving the construction of an ARC, no court has *ever* deferred to FERC's interpretation. The cases that petitioner cites all involve kinds of contracts or clauses *other than* ARCs in gas purchase contracts, generally species of contracts – such as "settlement agreements"[5] or FERC tar-

---

[5] *E.g.*, *National Fuel Gas Supply Corp.* v. *FERC*, 811 F.2d 1563 (D.C. Cir.), cert. denied, 484 U.S. 869 (1987); cf. *Consolidated Gas Supply Corp.* v. *FERC*, 745 F.2d 281, 291 & n.23 (4th Cir. 1984) (in case involving FERC-approved settlement agreement, tentatively suggesting some deference but also noting that "we have no occasion to retreat behind agency deference, though, were we to do so, it would only reinforce the result reached on a more direct and lawyerlike basis"), cert. denied, 472 U.S. 1008 (1985). Settlement agreements – that is, agreements settling disputes that otherwise would be adjudicated *before FERC* – present a more compelling case in general for deference to FERC than do ARCs, which simply govern the price of a transaction between a buyer and a seller in a regulated field and, in the event of disputes, need not

iffs[6] – that pertain uniquely to the FERC regulatory process and thus present a much different case for deference than ARCs.[7] In some of those cases, moreover, the court did *not* defer to FERC on questions of law. *E.g., Amoco Production Co.* v. *FERC*, 765 F.2d 686, 690 (7th Cir. 1985) ("[O]ur deference is not nearly so marked as it would be in reviewing a purely regulatory determination of the Commission * * *. Our task is to find whether the Commission's

---

even be adjudicated before FERC. Some settlement agreements present particularly compelling cases for deference. See *National Fuel Gas*, 811 F.2d at 1571 ("A further reason, at least in this case, for this court to defer to the Commission's reading of this settlement agreement is that Congress required the Commission to take an active role in approving the agreement.") The Fifth Circuit itself has deferred to FERC's construction of settlement agreements in appropriate cases. See, *e.g.*, *El Paso Natural Gas Co.* v. *FERC*, 881 F.2d 161, 164 (5th Cir. 1989) ("In support of its construction of the 1985 settlement in the instant case, the Commission relies not only on the language of the 1985 settlement itself but also on agency expertise; therefore, some deference to the interpretation by the Commission of the 1985 settlement is warranted.").

[6] *E.g., Northwest Pipeline Corp.* v. *FERC*, 61 F.3d 1479, 1486 (10th Cir. 1995); *Natural Gas Clearinghouse* v. *FERC*, 965 F.2d 1066, 1070 (D.C. Cir. 1992). There is no basis whatever for petitioner's attempt, via bald assertion, to equate the ARCs in his contracts, private agreements that simply exist in a regulated field, with tariffs placed on file at an agency. See Pet. 10 (asserting that "Scarth's contracts with NICOR are its FERC tariffs").

[7] In *Pacific Gas & Electric Co.* v. *FERC*, 746 F.2d 1383, 1387 (9th Cir. 1984), in a context far afield from the present one, the court deferred to FERC's construction of a contract governing electricity transmission service over the Pacific Northwest-Southwest Intertie "[b]ecause the FERC interpretation was so clearly based upon the agency's expertise in electricity transmission regulation." That holding is of no assistance to petitioner here, because the agency in this case did not rely on any factual or technical expertise. See Pet. App. 10a. Instead, it "decide[d] the matter *solely* by reviewing the express terms of the area rate clause." Pet. App. 56a (emphasis added).

interpretation of the contract was reasonable *and in full conformance with law.*") (emphasis added).

The D.C. Circuit, the leading court championing deference to FERC contractual interpretations in certain cases,[8] has *not* deferred to FERC when it has considered ARCs. Rather, in *Associated Gas Distributors* v. *FERC*, 810 F.2d 226 (D.C. Cir. 1987) (Ruth Bader Ginsburg, J.), and *South Dakota Public Utilities Commission* v. *FERC*, 934 F.2d 346 (D.C. Cir. 1991), cert. denied, 112 S. Ct. 1244 (1992), the court addressed FERC's treatment of ARCs *without* any deference to the Commission's legal conclusions. In neither of those cases did the court cite *Chevron* or any of the D.C. Circuit's decisions applying *Chevron* to FERC interpretations of certain contracts; instead, the D.C. Circuit has consistently cited with approval the very Fifth Circuit *Pennzoil* opinions that petitioner now attacks. See 810 F.2d at 229, 230 & n.2, 231 & n.4, 233; 934 F.2d at 349, 353.

Most pointedly, Judge (now Justice) Ginsburg stated for the court in *Associated Gas Distributors* that "[w]hat is no longer arguably in court as a result of the 1981 *Pennzoil* decision is the appropriateness of using a private contract frame of reference and, particularly, the intent-based standards of private contract law." 810 F.2d at 231 n.4. Thus, contrary to petitioner's claim, the D.C. Circuit joins the Fifth Circuit in recognizing that ARC cases, although they sometimes may happen to be tried before an administrative agency rather than a court, are private contract disputes to be resolved according to the usual means of deciding such disputes (including *de novo* judicial review of questions of law), not governmental decisions to which *Chevron* applies.[9]

---

[8] See *Williams National Gas Co.* v. *FERC*, 3 F.3d 1544 (D.C. Cir. 1993); *National Gas Fuel Supply Corp.* v. *FERC*, *supra*.

[9] The D.C. Circuit has also limited its deference holdings to situations in which "FERC * * * is reading the contract term for a limited regula-

And, because the other circuits whose decisions petitioner cites have followed the D.C. Circuit's non-ARC precedents[10] – and have not been addressing ARC cases – petitioner's claim of a circuit conflict evaporates.

The Fifth Circuit's *Pennzoil I* analysis explains – in a manner never questioned by any other circuit – why ARCs do *not* present a good case for deference to FERC. Under the complex regulatory scheme of the Natural Gas Act of 1938 (NGA), 15 U.S.C. § 717, *et seq.*, and the NGPA, gas purchase contracts sometimes will – and sometimes will not – be within FERC jurisdiction to interpret. 645 F.2d at 380-382. Thus, ARCs in gas purchase contracts, unlike various other kinds of contractual provisions that FERC may interpret, will be "left to state or federal courts" in many instances. *Id.* at 382. It follows that it would be illogical either to apply a specially made body of federal law to ARC disputes, or to defer to FERC's interpretation:

> *Erie* is necessarily implicated in this case because FERC has concurrent jurisdiction with state and federal courts over interpretation of escalation provisions in contracts that remain within FERC's NGA jurisdiction, and because only courts have jurisdiction to interpret escalation provisions in contracts not within FERC's NGA jurisdiction * * *. The very evil that *Erie* addressed would arise if FERC followed one substantive rule while state courts followed another: parties whose contracts are within concurrent FERC and court jurisdiction would be

---

tory purpose, * * * and not to determine the parties' ultimate contractual rights and responsibilities." *Transwestern Pipeline Co.* v. *FERC*, 988 F.2d 169, 173 (D.C. Cir. 1993); accord *Williams*, 3 F.3d at 1550. In ARC cases, FERC determines the parties' ultimate contractual rights and responsibilities.

[10] *E.g.*, *Northwest Pipeline Corp.*, 61 F.3d at 1486 ("we adopt the reasoning of the District of Columbia Circuit as applied in *Williams*").

> subject to two different rules for the same conduct, and each would have an incentive to have their contract interpreted in the forum applying the rule most favorable to that party.

Id. at 384; see also *id.* at 385-386 & nn.53-54; *Pennzoil II*, 789 F.2d at 1135-1136.

In any event, even if ARCs were indistinguishable from other kinds of contracts, to whose interpretation by FERC some circuits have given deference, *this case* would be an inappropriate occasion for deferring to FERC's interpretation, because of FERC's vacillating interpretation of the contracts at issue. The argument supporting deference to FERC on issues of contract interpretation can be traced back, directly or indirectly through *Williams Natural Gas*, to Judge Bork's opinion for the D.C. Circuit in *National Fuel Gas Supply Co.* v. *FERC, supra*. As Judge Bork was careful in that case to point out, "deference would be inappropriate * * * [i]f the agency's interpretation of a contract has vacillated." 811 F.2d at 1571.

It is difficult to imagine a more compelling instance than this case of a "vacillat[ing]" FERC interpretation not entitled to deference under even the most generous of standards. FERC originally *affirmed* the ALJ's ruling in NICOR's favor, calling it "amply supported" (Pet. App. 33a) and citing in particular "the most logical, most obvious, most natural and most reasonable interpretation of the * * * language" of the clauses (*id.* at 52a). Yet, on rehearing, the *very same language* was construed as dispositive *against* NICOR. Such flagrant inconsistencies defeat an agency's claim to deference even when a *statute* is at issue. See, *e.g.*, *Bowen* v. *Georgetown University Hospital*, 488 U.S. 204, 212-213 (1988).

It is hardly surprising, then, that FERC has not come to this Court seeking review of the Fifth Circuit's no-deference holding in this case. Only the disappointed intervenor –

who did not raise the issue below – urges this Court to resolve a supposed conflict in the circuits. But that conflict is illusory in this case; *no court* would have deferred to FERC's construction of the ARCs at issue here. There is no sufficient reason to grant certiorari on this issue.

2. Petitioner's second argument, made at great length (Pet. 13-25), is that the Fifth Circuit misapplied the substantial evidence standard of review. The short answer is that the Fifth Circuit had no occasion to misapply (or even to apply correctly) the substantial evidence standard, because it accepted, for the sake of disposition, every single one of the agency's factual findings. The *only* factual finding that ultimately mattered in this case – and one the agency reaffirmed repeatedly (Pet. App. 51a, 61a-64a, 82a) – was that petitioner failed to prove his position by a preponderance of the evidence. See Pet. App. 12a-13a.[11]

Petitioner's disagreement with the application of the substantial evidence standard by the court of appeals would not warrant a grant of certiorari even if the Fifth Circuit *had* applied that standard and disagreed with some of the agency's conclusions. "[A] question of fact * * * does not merit Court review." *NLRB* v. *Hendricks County Rural Electric Membership Corp.*, 454 U.S. 170, 176 n.8 (1981) (dismissing cross-petition as improvidently granted); *Rudolph* v. *United States*, 370 U.S. 269, 270 (1962) (per curiam) (review of facts "would be of no importance save to the litigants themselves"). See generally R. STERN, E. GRESSMAN,

---

[11] Petitioner complains repeatedly that the Fifth Circuit did not advert to certain FERC conclusions that petitioner labels (often fancifully) "*factual finding[s].*" Pet. 17 n.12, 18, 19, 20 & n.15. The reason the Fifth Circuit did not advert to those conclusions is that they were *legally irrelevant* under the Fifth Circuit's analysis, not that the Fifth Circuit rejected them as factually unsupported. *Nowhere* in the Fifth Circuit's opinion is any FERC factual finding questioned in the slightest.

S. SHAPIRO & K. GELLER, SUPREME COURT PRACTICE 189-191 (7th ed. 1993).

3. Petitioner's third argument (Pet. 25-29) -- that the court of appeals misapplied Oklahoma law to construction of the contracts – presents no ground for a grant of certiorari. "[T]he interpretation of private contracts is ordinarily a question of state law, which this Court does not sit to review." *Volt Information Sciences, Inc.* v. *Board of Trustees*, 489 U.S. 468, 474 (1989); see also *Haring* v. *Prosise*, 462 U.S. 306, 314 n.8 (1983); *Butner* v. *United States*, 440 U.S. 48, 57-58 (1979); *Cort* v. *Ash*, 422 U.S. 66, 73 n.6 (1975); SUPREME COURT PRACTICE, *supra*, at 183-184.

Furthermore, petitioner's attacks on the court of appeals' application of Oklahoma law rest on a series of misstatements. Petitioner claims, for example, that NICOR "drafted the GHK and Sun ARCs" (Pet. 28), but FERC did not so find, and the record is far from clear on this point (Tr. 276-277, 364, 392, 455; Ex. 102). Petitioner claims that "FERC * * * properly considered *all* of the evidence, * * * and found that the greater weight of *all* evidence proved that Scarth met his burden" (Pet. 26), yet that is not what FERC did. Indeed, FERC neither considered all the evidence not found that such evidence discharged Scarth's burden of persuasion. By its own admission (Pet. App. 56a), FERC disregarded all of the extrinsic evidence merely because it was "inconclusive" and rested on the ambiguous contract language alone, in contravention of multiple Oklahoma statutes and cases cited by the court of appeals (Pet. App. 10a-11a). And FERC's disregard for normal and Oklahoma-specific principles of construction did not end there; FERC also refused to interpret contractual language in its "most logical" and "most natural" way (Pet. App. 52a), because it preferred the artificial linguistic straitjacket of FERC Opinion No. 77. Pet. App. 70a-71a, 95a. Although petitioner claims that FERC acted consistently with Oklahoma law in applying "construction rules" (Pet. 27), petitioner does not and cannot

make any effort to show that the bizarre construction rules FERC applied have a basis in Oklahoma law. Petitioner's effort to reconcile FERC's decision with Oklahoma law is remarkably strained and, in any event, presents no cert-worthy issue.

4. Finally, petitioner argues in a single paragraph (Pet. 29-30) that the court of appeals exceeded its authority by remanding with directions instead of remanding for further proceedings. Although petitioner claims that the decision below "usurps administrative discretion" (Pet. 30), petitioner fails to identify *what* discretion it thinks FERC would have had left to exercise once the court of appeals ruled that petitioner's failure to meet his burden of proof was dispositive. There were no issues remaining for administrative resolution, and a remand to the agency would have been pointless – as the agency itself seems to believe, since it neither petitioned for further review nor hesitated to comply with the mandate of the court of appeals.

Petitioner correctly states the *general* principle of administrative law that a reviewing court must remand to an agency once its decision has corrected the agency's error of law. But there is nothing absolute about that principle,[12] and it certainly is not a principle designed to create unnecessary work for agencies (much less for this Court on certiorari) when a case can have only one outcome under the governing legal principles. FERC – not the court of appeals – found the key fact here, namely that petitioner had not met his burden of proof. The court of appeals held that that fact, found by FERC, disposed of the case. Pet. App. 12a-13a. There was nothing left for FERC to do, and a remand would

---

[12] Courts of appeals have on several occasions remanded cases to agencies with directions to enter a particular judgment or order. *E.g.*, *Hunt Oil Co.* v. *FERC*, *supra*; *Rivera* v. *Sullivan*, 923 F.2d 964, 970 (2d Cir. 1991); *AFGE* v. *FLRA*, 786 F.2d 554, 557 (2d Cir. 1986); *Diamond Ring Ranch, Inc.* v. *Morton*, 531 F.2d 1397, 1407 (10th Cir. 1976).

have been pointless. A grant of certiorari would be even more so.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

ROY T. ENGLERT, JR.
Mayer, Brown & Platt
2000 Pennsylvania Ave., N.W.
Washington, D.C. 20006

H. BRUCE GOLDEN
Counsel of Record
Golden & Associates, P.C.
4500 NationsBank Center
Houston, TX 77002
(713) 223-2600

J. BRENT GARFIELD
Nicor Oil & Gas Corporation
1050 Seventeenth Street
Suite 1280
Denver, CO 80265

Counsel for Respondent

NOVEMBER 1995

APPENDIX

Excerpt (pp. 27-28) from "Brief of Intervenor, Robert W. Scarth, et. [*sic*] al."

II. FERC PROPERLY INTERPRETED THE ARC'S IN THIS CASE AS PERMITTING NGPA INCENTIVE PRICES

A. Standard of Review

NICOR maintains that "[t]his Court's review is *de novo*" because "[t]he sole underlying question" is "one of contract interpretation." Br. at 15. If contract interpretation were the only issue NICOR had raised, *de novo* review might be the exclusive standard. However, NICOR also maintains that FERC was wrong in its factual finding that the extrinsic evidence which NICOR had presented was inconclusive. Br. at 24-37. FERC's resolution of issues of fact, unlike its resolution of issues of law, are [*sic*] reviewed under the substantial evidence standard. *Hunt*, 853 F.2d at 1235. Substantial evidence is such evidence that a "reasonable mind might accept as adequate to support a conclusion," and is "less than the weight of the evidence." *Pennzoil II*, 789 F.2d at 1135, n.20. Substantial evidence is "more than a mere scintilla, and less than a preponderance," and "'[t]his Court may not reweigh the evidence or try the issues de novo. Conflicts in evidence are for the [agency] and not the courts to resolve.'" *Spellman v. Shalala*, 1 F.3d 357, 360 (5th Cir. 1993) (citation omitted). Thus, FERC's finding of inconclusiveness as to NICOR's extrinsic factual evidence is reviewed under the substantial evidence standard, and not *de novo* as NICOR maintains.

Finally, Scarth concurs in FERC's position in its brief (pp. 19-21) that no "special scrutiny" is required because FERC concurred with the ALJ (*see also* § (C)(1), *infra*), and that deference to FERC is appropriate in view of its specialized expertise, particularly with respect to interpreting and applying its own rules and orders. In any event, as Scarth shows below, even if *de novo* review is applied, the plain contractual language, regulatory and commercial context, and course of performance of the parties show that *all* NGPA prices are contractually authorized.

Supreme Court, U.S.
FILED
DEC 4 1995
OFFICE OF THE CLERK

No. 95-554

In the Supreme Court of the United States

OCTOBER TERM, 1995

ROBERT W. SCARTH, ET AL., PETITIONERS

v.

NICOR EXPLORATION COMPANY, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

DREW S. DAYS, III
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 514-2217

SUSAN TOMASKY
General Counsel
JEROME M. FEIT
Solicitor
JOSEPH S. DAVIES
Deputy Solicitor
JANET KAY JONES
Attorney
Federal Energy Regulatory Commission
Washington, D.C. 20426

QUESTION PRESENTED

Whether the court of appeals correctly set aside an order of the Federal Energy Regulatory Commission that interpreted clauses specifying statutorily regulated rates for the wellhead sale of natural gas.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	2
Statement	2
Argument	8
Conclusion	11

TABLE OF AUTHORITIES

Cases:

Chevron U.S.A. Inc. v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984)	10
Consolidated Gas Supply Corp. v. *FERC*, 745 F.2d 281 (4th Cir. 1984)	9-10
FPC v. *Idaho Power Co.*, 344 U.S. 17 (1952)	10
Hunt Oil Co. v. *FERC*, 853 F.2d 1226 (5th Cir. 1988)	7
Independent Oil & Gas Ass'n of West Virginia, 10 F.E.R.C. ¶ 61,214 (1980), petitions for review dismissed, *Pennzoil Co.* v. *FERC*, 645 F.2d 394 (5th Cir. 1981)	5
National Fuel Gas Supply Corp. v. *FERC*, 811 F.2d 1563 (D.C. Cir.), cert. denied, 484 U.S. 869 (1987)	9
Northwest Pipeline Corp. v. *FERC*, 61 F.3d 1479 (10th Cir. 1995)	9
Order 23, 6 F.E.R.C. ¶ 61,229 (1979)	4, 5
Order 23-A, 7 F.E.R.C. ¶ 61,247 (1979)	4
Order 23-B, 8 F.E.R.C. ¶ 61,130 (1979)	4
Order 329, 36 F.P.C. 925 (1966)	3
Pennzoil Co. v. *FERC*:	
645 F.2d 360 (5th Cir. 1981), cert. denied, 454 U.S. 1142 (1982)	3, 4, 7, 8
789 F.2d 1128 (5th Cir. 1986)	3, 4
Williams Natural Gas Co. v. *FERC*, 3 F.3d 1544 (D.C. Cir. 1993)	9

Statutes and regulation: Page

Department of Energy Organization Act, § 402(a), 42 U.S.C. 7172(a) 2
Natural Gas Act, 15 U.S.C. 717 *et seq.* 2, 3
Natural Gas Policy Act of 1978, 15 U.S.C. 3301 *et seq.* 3
§ 104, 15 U.S.C. 3314 (1988) 3, 4
§ 108, 15 U.S.C. 3318 (1988) 2, 4, 5, 6, 7
Natural Gas Wellhead Decontrol Act of 1989, Pub. L. No. 101-60, 103 Stat. 157 ..... 2, 8
Exec. Order No. 12,009, 3 C.F.R. 142 (1978) 2

Miscellaneous:

42 Fed. Reg. 46,267 (1977) 2

In the Supreme Court of the United States

OCTOBER TERM, 1995

No. 95-554

ROBERT W. SCARTH, ET AL., PETITIONERS

v.

NICOR EXPLORATION COMPANY, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-14a) is reported at 50 F.3d 1341. The orders of the Federal Energy Regulatory Commission are reported at 58 F.E.R.C. ¶ 61,203 (affirming administrative law judge) (Pet. App. 32a-53a); 63 F.E.R.C. ¶ 61,034 (granting rehearing in part) (Pet. App. 54a-75a), and 66 F.E.R.C. ¶ 61,276 (denying rehearing) (Pet. App. 76a-99a). The initial decision of the administrative law judge (Pet. App. 15a-31a) is reported at 56 F.E.R.C. ¶ 63,023.

JURISDICTION

The judgment of the court of appeals was entered on April 27, 1995. A petition for rehearing was denied on July 5, 1995. Pet. App. 100a. The petition for a writ of certiorari was filed on October 3, 1995. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

This case concerns implementation of the federal statutory schemes that formerly governed natural gas rates and were administered by the Federal Energy Regulatory Commission (FERC or the Commission) and its predecessor, the Federal Power Commission (FPC).[1] The underlying dispute focused on whether certain clauses in contracts drafted in 1970 for the sale of natural gas authorized petitioners to charge respondent NICOR Exploration Company (NICOR) incentive-based rates pursuant to Section 108 of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3318 (1988), or whether those clauses restricted petitioners to the "just and reasonable" cost-based rates prescribed by the FPC under the Natural Gas Act (NGA), 15 U.S.C. 717 *et seq.*, that prevailed when the contract was made.[2] An administrative law judge concluded that the clauses did not authorize the new, higher rates. After initially affirming the adminis-

---

[1] FERC assumed the FPC's functions and responsibilities on October 1, 1977. Department of Energy Organization Act § 402(a), 42 U.S.C. 7172(a); Exec. Order No. 12,009, 3 C.F.R. 142 (1978); 42 Fed. Reg. 46,267 (1977).

[2] As a result of the Natural Gas Wellhead Decontrol Act of 1989, Pub. L. No. 101-60, 103 Stat. 157, FERC no longer has jurisdiction over natural gas rates.

trative law judge, the Commission reconsidered and reversed its earlier order and determined that the contracts allowed such rates. The court of appeals vacated the Commission's order on the ground that the Commission had not properly applied Oklahoma state law in interpreting the contract clause, thereby giving inadequate consideration to extrinsic evidence of the contracting parties' intent to allow future rate increases, and improperly shifting the burden of proof from petitioners to NICOR regarding that intent.

1. a. The rate-clause interpretation issue in this case arises from the change in the statutory scheme governing natural gas rates effected by the enactment of the NGPA, 15 U.S.C. 3301 *et seq.*, which adopted rate-setting methodologies that differed in some respects from those established in the NGA, 15 U.S.C. 717 *et seq.* Before 1978, the FPC acted under the NGA to establish "just and reasonable" wellhead rates for the sale of natural gas based on a producer's costs. During the gas shortages of the 1970s, gas supply contracts typically contained "area rate clauses," a type of price escalator clause that automatically raised the cost-based contractual price to the maximum "just and reasonable" ceiling rate authorized by the Commission in rate proceedings for a particular geographic area. See *Pennzoil Co.* v. *FERC* (*Pennzoil I*), 645 F.2d 360, 366-367 (5th Cir. 1981), cert. denied, 454 U.S. 1142 (1982); Order 329, 36 F.P.C. 925 (1966).

Congress's enactment of the NGPA in 1978 altered the existing scheme governing rates for wellhead sales of natural gas. The NGPA substituted statutorily set rates for rates prescribed by FERC. Pet. App. 3a; *Pennzoil Co.* v. *FERC* (*Pennzoil II*), 789 F.2d 1128, 1132 (5th Cir. 1986). While Section 104 of

the NGPA, 15 U.S.C. 3314 (1988), generally continued the earlier, cost-based methodology for setting rates for certain categories of natural gas, Section 108 allowed significantly higher, incentive-based rates for gas produced from "stripper wells." See Pet. App. 3a.[3]

b. In a set of orders collectively referred to as Order 23, the Commission determined that neither the NGPA nor its own regulations precluded producer-sellers whose contracts contained pre-NGPA area rate clauses from obtaining higher NGPA incentive rates. Order 23, 6 F.E.R.C. ¶ 61,229 (1979); Order 23-A, 7 F.E.R.C. ¶ 61,247 (1979); Order 23-B, 8 F.E.R.C. ¶ 61,130 (1979); see *Pennzoil II*, 789 F.2d at 1132; Pet. App. 4a. Rather than construing all such rate clauses uniformly, however, the Commission adopted a case-by-case approach, applying general principles of contract law. Pet. App. 4a. On review of Order 23, the Fifth Circuit affirmed in large part, but held that "specific determinations of contractual authority in the protest procedures must take account of and follow any differences with general contract law that the appropriate state contract law may have." *Pennzoil I*, 645 F.2d at 383-384. The court also noted that "the burden of proof [to show entitlement to the higher rates] is entirely on the seller since he is the party seeking the rate increase." *Id.* at 370.

c. In its first opinion resolving a specific controversy over an area rate clause, the Commission

---

[3] A "stripper well" produces not more than an average of 60 Mcf (thousand cubic feet) per day. Other than deregulated gas, this category receives the most favorable pricing treatment under the NGPA. *Pennzoil I*, 645 F.2d at 370 n.16 (citing Section 108 of the NGPA).

developed a two-step test for determining the contracting parties' mutual intent under Order 23. *Independent Oil & Gas Ass'n of West Virginia*, 10 F.E.R.C. ¶ 61,214 (1980) (Opinion 77), petitions for review dismissed without prejudice, *Pennzoil Co.* v. *FERC*, 645 F.2d 394 (5th Cir. 1981). The Commission's first step was to consider extrinsic evidence proffered by the parties regarding intent. Where the extrinsic evidence was inconclusive or unreliable, the Commission proceeded to the second step to examine the language of the area rate clause for specific features that would show an intent *not* to authorize incentive-based rates when such rates became available, as they did under Section 108 of the NGPA. The Commission identified three such features: (1) a reference to administratively prescribed or established rates; (2) the linking of such a reference to administrative action with a reference to either the NGA generally, or the NGA's "just and reasonable" standard specifically; and (3) an absence of additional language uncoupling that link. In the Commission's view, the presence of both (1) and (2)—*i.e.*, references to both administrative rate setting and the NGA—generally would indicate that the parties intended to authorize only cost-based rates, except where the clause affirmatively suggests that relevant administrative action need not be linked to the NGA price structure.

2. The contracts at issue in this case involved gas produced from an Oklahoma well. The contracts were executed in 1970 by NICOR, the purchaser of the gas, and the GHK Company, Sun Oil Company and Amerada Hess Corporation, the producer-sellers. Each contract contained a substantially similar area rate

clause.[4] Between 1988 and 1989, petitioners acquired the producers' interests in all three contracts and attempted to collect higher, incentive-based rates under Section 108 of the NGPA. NICOR contested the rate increases. Pet. App. 2a.

a. Following an evidentiary hearing, an administrative law judge (ALJ) ruled that the three contracts did not authorize the higher Section 108 rates. Pet. App. 15a-31a. The ALJ concluded that the extrinsic evidence did not support petitioners' contention that the parties intended the clauses to authorize the maximum rate increases allowed by law, and that the clauses' language satisfied the three criteria of Opinion 77, thus requiring the continued application of cost-based rates. *Id.* at 20a-21a.

After initially affirming the ALJ's decision, Pet. App. 32a-53a, the Commission granted rehearing and reversed, concluding that the contracts allowed petitioners to charge the incentive-based rates of Section 108 of the NGPA, *id.* at 54a-75a. The Commission

---

[4] The area rate clauses of the Sun and GHK contracts read as follows:

> If the Federal Power Commission, or any successor governmental authority having jurisdiction in the premises, shall at any time hereafter prescribe, for the area in which the contract is located, a higher, applicable, just and reasonable area rate for the purchase of gas than the price herein provided to be paid, then the price to be paid by the Buyer to Seller for gas delivered under the provisions of this Agreement shall be increased to equal such higher price effective as of the date such higher price is made applicable to the gas sold hereunder.

Pet. App. 2a-3a. Other than its omission of the phrase "just and reasonable," the Amerada Hess area rate clause was identical to the other two. *Id.* at 3a n.1.

agreed with the ALJ that extrinsic evidence failed to establish the parties' mutual intent to authorize the maximum legal rate increases. *Id.* at 57a-69a. Unlike the ALJ, however, the Commission concluded that the area rate clauses allowed Section 108 rates because each clause failed to satisfy one or more elements of Opinion 77's three-part test. *Id.* at 57a, 69a-75a.

b. The court of appeals vacated the Commission's order for failure correctly to apply Oklahoma law. Pet. App. 1a-14a.[5] The court acknowledged that in *Pennzoil I* it had affirmed the Commission's decision to formulate and apply general principles of contract law in construing area rate clauses, but noted that it had also required the Commission to "take account of and follow any differences with general contract law that the appropriate state contract law may have." *Id.* at 8a-9a (quoting *Pennzoil I*, 645 F.2d at 383-384). The court determined that no deference was due to the Commission's application of Oklahoma law to interpret the gas supply contracts at issue here, because the Commission had not used its factual or technical expertise. Pet. App. 10a. The court thus reviewed the Commission's order de novo. *Ibid.*

The court determined that Oklahoma law, as well as its own prior opinion in *Hunt Oil Co.* v. *FERC*, 853 F.2d 1226, 1237 (5th Cir. 1988), required the Commission to consider extrinsic evidence of intent in construing the area rate clauses. The court found FERC's approach "defective" because the Commission failed to consider the extrinsic evidence further after having found it inconclusive of the parties'

---

[5] The court held that Oklahoma law governed this proceeding because Oklahoma had had extensive contacts with the three contracts. Pet. App. 9a-10a.

intent. Even inconclusive extrinsic evidence, in the court's view, must be balanced with the indications in the text of the area rate clauses themselves to determine the parties' intent. Pet. App. 11a-12a. The Commission's approach was also inconsistent with Oklahoma law, the court concluded, because it "narrowly focuse[d] on specific phrases in the area rate clauses without considering the language of the clauses and contracts as a whole." *Id.* at 12a.

The court also determined that the Commission's approach "conflict[ed] with th[e] court's holding in *Pennzoil I* that the producer bears the burden of proving that an area rate clause authorizes incentive-based rates under the NGPA." Pet. App. 13a (citing *Pennzoil I*, 645 F.2d at 370). To the extent that Opinion 77's three-prong approach to analyzing the language of area rate clauses required NICOR to prove the *absence* of contractual authority for the higher, incentive-based rates, the court held that it impermissibly relieved petitioners of the burden of proof of authorization for the higher rates that they would have borne under Oklahoma law. Pet. App. 12a-13a.

ARGUMENT

1. The question whether courts must defer to FERC's interpretation of area rate clauses such as those at issue in this case is no longer significant, because, as a result of the Natural Gas Wellhead Decontrol Act of 1989, Pub. L. No. 101-60, 103 Stat. 157, FERC's jurisdiction over producer rates ended on January 1, 1993. As petitioners noted in their brief in the court of appeals (Pet. C.A. Br. 2 n.1), this may be the last of the "area rate clause" cases. Thus, although the Fifth Circuit's failure to afford defer-

ence to FERC's interpretation of the area rate clauses appears to be in tension with the approach of other courts of appeals with respect to FERC's interpretation of contracts in other settings, see, *e.g.*, *National Fuel Gas Supply Corp.* v. *FERC*, 811 F.2d 1563, 1568-1573 (D.C. Cir.) (FERC interpretation of FERC-approved settlement agreement), cert. denied, 484 U.S. 869 (1987),[6] review of that issue is best left to a case of lasting significance, rather than one tied to the interpretation of contracts under a statutory scheme that is no longer in place.[7] Moreover, if the

---

[6] *National Fuel*, 811 F.2d at 1569-1570, required deference on even "'pure' questions of law" regarding contract interpretation. Even under that standard, however, it is unclear whether the court of appeals would have reached a different conclusion in this case. If the court of appeals was correct that FERC shifted the burden of proof and employed canons of construction at odds with Oklahoma law, such errors likely would not have survived even the deferential review called for by *National Fuel*.

[7] In any event, none of the cases that petitioners cite (Pet. 9-12) actually conflicts with the decision below. Although the courts properly deferred to FERC, they did so in cases that did not involve area rate clauses, and that did not raise any question whether FERC's application of state-law canons of construction or its allocation of the burden of proof warrants deference. For example, in *Northwest Pipeline Corp.* v. *FERC*, 61 F.3d 1479, 1487 (10th Cir. 1995), the court did not reach the question whether FERC was entitled to deference with regard to canons of contract law because it determined that the Commission correctly applied the same canons of construction as would a reviewing court. *Williams Natural Gas Co.* v. *FERC*, 3 F.3d 1544, 1549 (D.C. Cir. 1993), addressed only the deference due FERC's construction of contract terms, and not the question whether legal canons of construction were properly applied. The court in *Consolidated Gas Supply Corp.*

issue should arise in other circumstances in the Fifth Circuit in the future, that court may conclude that the particular context warrants greater deference to FERC's interpretation or may reconsider and reconcile its general approach with the prevailing view under *Chevron U.S.A. Inc.* v. *Natural Resources Defense Counsel, Inc.*, 467 U.S. 837 (1984), without the intervention of this Court.

2. Petitioners' remaining contentions (Pet. Br. 13-30) likewise afford no basis for further review. Petitioners assert that the court of appeals failed to follow the substantial evidence standard for reviewing agency fact-findings, misinterpreted Oklahoma law, and usurped FERC's discretion by directing entry of an order in favor of NICOR rather than remanding the case for further proceedings. Those issues are factbound. Petitioners do not contend that the court announced a general rule regarding substantial evidence, but merely that the court failed to apply that principle here. To the extent that a misapplication of the general principle was involved, it cannot be expected to have ramifications beyond this case. The correct application of Oklahoma law to the facts of this case is similarly not a question of broad importance. Finally, although courts normally must remand when they set aside agency decisions, see *FPC* v. *Idaho Power Co.*, 344 U.S. 17, 20 (1952), the failure to do so here lacks practical significance, because the court's decision left FERC no option beyond requiring petitioners to rescind the unauthorized rates.

---

v. *FERC*, 745 F.2d 281, 291 (4th Cir. 1984), agreed with FERC's interpretation of the terms of a settlement agreement.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

DREW S. DAYS, III
Solicitor General

SUSAN TOMASKY
General Counsel

JEROME M. FEIT
Solicitor

JOSEPH S. DAVIES
Deputy Solicitor

JANET KAY JONES
Attorney
Federal Energy Regulatory Commission

DECEMBER 1995

Supreme Court, U.S.
FILED
DEC 18 1995
CLERK

No. 95-554

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1995

ROBERT W. SCARTH, *et al.*,
Petitioners,

v.

NICOR EXPLORATION COMPANY,
Respondent.

On Petition For Writ Of Certiorari To
The United States Court Of Appeals
For The Fifth Circuit

PETITIONERS' REPLY MEMORANDUM

BERNARD A. FOSTER, III
Counsel of Record
WILLIAM R. MAPES, JR.
DEBORAH A. CARPENTIER
ROSS, MARSH & FOSTER
1401 H Street, N.W.
Washington, D.C. 20005-2110
(202) 822-8888
Counsel for Petitioners

December 18, 1995

LIST OF PARTIES

Pursuant to Rule 29(6) of the Rules of the Supreme Court of the United States, a list of the Petitioners in this case is provided in the Petition for Writ of Certiorari filed by Robert W. Scarth, *et al.*, on October 3, 1995 in these proceedings. Included therein is a description of the corporate affiliations of any corporate petitioners.

TABLE OF CONTENTS

Page

LIST OF PARTIES i

TABLE OF AUTHORITIES iii

I. FERC'S OPPOSITION IS MISLEADING AND DOES NOT PRESENT A VALID BASIS FOR DENIAL OF CERTIORARI 1

II. THE DEFERENCE ISSUE WAS RAISED AND ADDRESSED BELOW AND SCARTH IS NOT FORECLOSED FROM ARGUING THE ISSUE 5

III. SCARTH DID NOT CONCEDE THAT THE *DE NOVO* STANDARD OF REVIEW WAS APPROPRIATE 6

IV. FERC'S ALLEGED "VACILLATION" DOES NOT PRECLUDE DEFERENCE 7

V. NICOR'S DISCUSSION OF THE SUBSTANTIAL EVIDENCE TEST WITH RESPECT TO THE FIFTH CIRCUIT JUDGMENT IS MISLEADING AND INACCURATE 8

CONCLUSION 10

APPENDIX A-1

TABLE OF AUTHORITIES

UNITED STATES SUPREME COURT CASES

Chevron, U.S.A., Inc. v. NRDC,
467 U.S. 837 (1984) . . . . . *passim*

FPC v. Sierra Pac. Power Co., 350 U.S. 348 (1956) 1, 2

Mobil Exploration Co. v. United Distribution Co.,
498 U.S. 211 (1991) 6

Mobil Oil Corp. v. FPC, 417 U.S. 283 (1974) 4

Pauley v. BethEnergy Mines, Inc., 501 U.S. 608 (1991) 6

*United Gas Pipe Line Co. v. Mobile Gas
Serv. Corp.*, 350 U.S. 332 (1956) 1, 2

FEDERAL CASES

Coca-Cola Co. v. Atchison, T. & S.F. Ry.,
608 F.2d 213 (5th Cir. 1979) 2

NICOR Expl. Co. v. FERC, 50 F.3d 1341
(5th Cir. 1995) (Pet. App. 1a-14a) 6, 9

Northwest Pipeline Corp. v. FERC, 61 F.3d 1479
(10th Cir. 1995) 2

Williams Natural Gas Co. v. FERC,
3 F.3d 1544 (D.C. Cir. 1993) 2, 8

ADMINISTRATIVE CASES

Opinion 77, 10 F.E.R.C. (CCH) ¶ 61,214 (1980) . . 7, 9

NICOR Expl. Co., 63 F.E.R.C. (CCH)
¶ 61,034 (1993) (Pet. App. 54a-75a) 8, 9, 10

NICOR Expl. Co., 66 F.E.R.C. (CCH)
¶ 61,276 (1994) (Pet. App. 76a-99a) 8, 9, 10

Order No. 23, 6 F.E.R.C. (CCH) ¶ 61,229, *reh'g*,
7 F.E.R.C. (CCH) ¶ 61,152, Order No. 23-A, 7
F.E.R.C. (CCH) ¶ 61,247, *reh'g*, 8 F.E.R.C. (CCH)
¶ 61,130, *reh'g*, 8 F.E.R.C. (CCH) ¶ 61,158 (1979) . 7

*Removal of Outdated Regulations Pertaining to the
Sales of Natural Gas Production*, Order No. 567, III
F.E.R.C. Stats. & Regs. (CCH) ¶ 30,999 (1994) . . iv, 7

STATUTES

Natural Gas Act § 19(b), 15 U.S.C. § 717r(b) 3

OTHER

Sup. Ct. R. 15.6 1
Fed. R. App. P. 28(i) 6
18 C.F.R. § 154.93(b-1) (1992)* (Pet. App. 121a) . . . 7

---

*This regulation was removed from FERC's regulations. *Removal of Outdated Regulations Pertaining to the Sales of Natural Gas Production*, Order No. 567, III F.E.R.C. Stats. & Regs. (CCH) ¶ 30,999 (1994).

Pursuant to Rule 15.6 of the Supreme Court Rules, Petitioners, Robert W. Scarth, *et al.* ("Scarth"), respectfully reply to the Brief in Opposition filed by the Federal Energy Regulatory Commission ("FERC"), Respondent below, and to the Brief in Opposition filed by Respondent, NICOR Exploration Company ("NICOR")

I. FERC'S OPPOSITION IS MISLEADING AND DOES NOT PRESENT A VALID BASIS FOR DENIAL OF CERTIORARI

A. FERC claims that the application of *Chevron*[1] deference in this case is "no longer significant" because its jurisdiction over producer rates and contracts ended on January 1, 1993. Br. Opp. at 8. FERC's claim is, at best, misleading. This case does have important, continuing significance because FERC continues, as it did here, to regulate and interpret contracts under the Natural Gas Act ("NGA"). Thus, the split of circuits regarding the applicability of *Chevron* deference to FERC's interpretation of contracts under such statute should be resolved.

As FERC observed below, "[i]t is undisputed that under the NGA and the NGPA, jurisdiction to resolve contract disputes such as this one arising out of a regulatory scheme established by Congress resides, in the first instance, with the Commission." FERC 5th Cir. Br. at 19. FERC's NGA jurisdiction to review and interpret contracts stems from this Court's rulings in *Mobile-Sierra.*[2] These cases

---

[1] *Chevron, U.S.A., Inc. v. NRDC*, 467 U.S. 837 (1984)

[2] *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956); *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956).

hold that, unlike other types of regulatory statutes, a rate applicant under the NGA, such as Scarth, must have underlying contractual authority to collect the rates it proposes. Thus, under the NGA it is incumbent upon FERC to interpret a rate applicant's contract, as it did here, to ensure that there is contractual authority for the rate increase proposed. In turn, under *Chevron* as applied by the majority of circuits, FERC's contract interpretation is entitled to judicial deference.

Although, as FERC points out, producer gas sales have been decontrolled, FERC nevertheless still continues to regulate the rates of interstate gas pipelines under the NGA. Consequently, the issue of deference to FERC's contract interpretations under the NGA and *Mobile-Sierra* is a continuing issue of significance. The continuing nature of this issue is demonstrated by recent judicial deference rulings relative to FERC interpretations of pipeline contracts subsequent to producer decontrol.[3] In fact, even FERC acknowledges the continuing significance of this issue, noting that the Fifth Circuit *in the future* "may reconsider *and* reconcile its general approach *with the prevailing view* under *Chevron* . . . without the intervention of this Court." Br. Opp. at 10 (emphasis added). *See also id.* at 8-9 ("the Fifth Circuit's failure to afford deference to FERC . . . [here] appears to be in tension with the approach of other courts of

---

[3]*See Northwest Pipeline Corp. v. FERC*, 61 F.3d 1479, 1486 (10th Cir. 1995). *Northwest* involved deference to FERC's interpretation of a pipeline tariff, which "are binding contracts." *See Coca-Cola Co. v. Atchison, T. & S.F. Ry.*, 608 F.2d, 213, 219 (5th Cir. 1979); *Williams Natural Gas Co. v. FERC*, 3 F.3d 1544, 1551 (D.C. Cir. 1993).

appeals with respect to FERC's interpretation of contracts in other settings.").

While thereby acknowledging that the Fifth Circuit's refusal to follow *Chevron* is erroneous, FERC nevertheless opposes certiorari. FERC knows that most circuits, including the critical D.C. Circuit where many FERC cases are brought, accord deference to FERC's contract interpretations. Apparently, FERC fears that the Court may review *Chevron* and possibly erode the deference now accorded to its contract interpretations by many circuits. However, this rationale does not provide a valid basis for denying certiorari. To the contrary, FERC's opposition only serves to encourage improper forum shopping, not only relative to future FERC contract interpretation cases, but also as to future contract interpretation actions by other administrative agencies. On the other hand, a grant of Scarth's petition will permit *Chevron* to be clarified so that the several circuits will not continue, as they do now, to apply disparate *Chevron* interpretations.

B. FERC claims that Scarth's assertion relative to the Fifth Circuits's failure to follow the substantial evidence standard affords no basis for review because that issue allegedly is "factbound." Br. Opp. at 10. However, the substantial evidence test is a rule of law, and it is the rule of law embodied in that test that the Fifth Circuit failed to apply. While *any* substantial evidence case involves "facts," the Fifth Circuit did not adhere to the requirement of law in the NGA that "[t]he finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive." 15 U.S.C. § 717r(b). This Court has granted

certiorari where, as here, the court below "misapprehended or grossly misapplied the substantial-evidence test." *Mobil Oil Corp. v. FPC*, 417 U.S. 283, 292 (1974).

C. FERC also maintains that the "correct application of Oklahoma law to the facts of this case" also is "factbound." Br. Opp. at 10. FERC misstates the issue presented in Scarth's Petition. Rather than the application of law to particular facts, the Petition instead presents the underlying basic issue that the Fifth Circuit *failed to apply the law of Oklahoma*. Notably, even FERC below told the Fifth Circuit that its orders' "reliance on contract interpretation standards . . . was consistent with . . . Oklahoma state law." FERC 5th Cir. Br. at 17.

D. FERC also contends that the Fifth Circuit's conflict with this Court's decisions concerning the scope of agency authority on remand is "factbound" and allegedly lacks practical significance because the court's decision "left FERC no option." Br. Opp. at 10. FERC's position is erroneous, as reflected by its statement *of law* that "courts normally must remand when they set aside agency decisions." *Id.* That the Fifth Circuit "left FERC no option" does not show a lack of practical significance. Instead, it shows that the Fifth Circuit's remand is in conflict with FERC's own acknowledged view of the law.

II. THE DEFERENCE ISSUE WAS RAISED AND ADDRESSED BELOW AND SCARTH IS NOT FORECLOSED FROM ARGUING THE ISSUE

NICOR argues that Scarth "never urged below" the deference argument based on *Chevron*, and that Scarth therefore is foreclosed from raising it here. Br. Opp. at 11. This simply is not true. The issue of deference was raised before the Fifth Circuit and addressed by that court. Therefore, the issue is properly before the Court.

In its brief to the Fifth Circuit, filed fifteen days before Scarth's brief, FERC clearly invoked the deference principle before the Fifth Circuit:

> The Commission's interpretation of the contracts at issue in this case is entitled to deference. . . . It is undisputed that under the NGA and the NGPA, jurisdiction to resolve contract disputes such as this one arising out of a regulatory scheme established by Congress resides, in the first instance, with the Commission . . . since it is the Commission which is intimately involved with establishing general standards for resolving such claims under Congress' statutory framework. Here, the Commission's contract interpretation was based on the specialized expertise that it applied in developing standards in Order 23 and Opinion 77 for use in resolving area rate clause disputes. Particularly with respect to the NGPA and its implementation, the Supreme Court has made it clear that "[w]e are neither inclined nor prepared to second-guess the agency's reasoned

determination in this complex area." *Mobil Exploration Co. v. United Distribution Co.*, 498 U.S. 211, 231 (1991).[4]

Consistent with Rule 28(i) of the Federal Rules of Appellate Procedure, Scarth in his Fifth Circuit brief stated he "concurs in FERC's position in its brief . . . that deference to FERC is appropriate in view of its specialized expertise," rather than repeating FERC's deference argument. Scarth Br. at 28, attached as the Appendix to NICOR Br. Opp. Thus, the issue of deference clearly was before the Fifth Circuit, as argued by both FERC and Scarth.[5] Moreover, the Fifth Circuit expressly addressed the deference issue, declaring that *de novo* review instead was appropriate. App. 10a.

III. SCARTH DID NOT CONCEDE THAT THE *DE NOVO* STANDARD OF REVIEW WAS APPROPRIATE

NICOR claims that Scarth below conceded that the *de novo* standard of review was appropriate. Br. Opp. at i. To the contrary, as noted above, Scarth in its Fifth Circuit brief

---

[4]FERC 5th Cir. Br. at 19-20 (citation omitted). FERC there quoted a more recent *Chevron* deference case: "deference is particularly appropriate when, as here, the question of interpretation arises under 'a complex and highly technical regulatory program' entailing 'significant expertise, and * * * the exercise of judgment grounded in policy concerns'." *Id.* at 20, *quoting*, *Pauley v. BethEnergy Mines, Inc.*, 501 U.S. 608 (1991).

[5] Scarth also addressed *Chevron* deference in his Petition for Rehearing *En Banc*. *See* App. hereto.

adopted FERC's position that deference is required respecting FERC's interpretations of "area rate clauses" made pursuant to its delegated statutory powers and special expertise. In the language now quoted by NICOR, Scarth merely acknowledged that "[i]f contract interpretation were the only issue . . . *de novo* review might be the exclusive standard." Scarth 5th Cir. Br. at 27. However, contract interpretation was *not* the only issue, because the case also involved: (1) an agency interpretation of its enabling statutes (in Order 23 and Opinion 77, the bases of the orders below); (2) the application and interpretation of rules established to implement the agency's statutory duty (the Opinion 77 rules); and (3) the agency's exercise of its statutory duties and the application of its interpretation of statutes and its own rules and regulations to particular "area rate clauses" within its jurisdiction. Indeed, the contracts' "area rate clause" provision only has meaning because FERC or its predecessor agency has regulated the "area rate" referenced in the clause, and the language of such clauses necessarily track FERC's regulatory language. *See* 18 C.F.R. § 154.93(b-1) (1992);[6] App. 121a. In such instances *Chevron* deference is required.

IV. FERC'S ALLEGED "VACILLATION" DOES NOT PRECLUDE DEFERENCE

NICOR argues alternatively that FERC is not entitled to deference because FERC allegedly "vacillated" by

---

[6]This regulation was removed from FERC's regulations. *Removal of Outdated Regulations Pertaining to the Sales of Natural Gas Production*, Order No. 567, III F.E.R.C. Stats. & Regs. (CCH) ¶ 30,999 (1994).

changing its position on rehearing. Br. Opp. at 11, 15-16. NICOR is wrong. The D.C. Circuit has found that the very purpose of statutory rehearing would be thwarted if *Chevron* deference were denied simply because FERC changed its position on reconsideration. *Williams Natural Gas Co. v. FERC*, 3 F.3d 1544, 1550-51 (D.C. Cir. 1993). Importantly, here, FERC set forth in great detail in two thorough opinions its reasons for correcting its original errors. App. 54a-75a, 76a-99a. Under these circumstances, *Chevron* deference should have been accorded.

V. NICOR'S DISCUSSION OF THE SUBSTANTIAL EVIDENCE TEST WITH RESPECT TO THE FIFTH CIRCUIT JUDGMENT IS MISLEADING AND INACCURATE

A. NICOR claims erroneously that the Fifth Circuit adopted an alleged FERC finding that Scarth had not met his burden of proof.[7] To the contrary, in a section headed "Burden of Proof and Procedures," FERC specifically held that it properly placed the burden of proof upon Scarth, and that "[t]he Commission simply found that Scarth met it, for reasons set forth in the order." App. at 82a. Indeed, had FERC actually found, as NICOR now

---

[7] *E.g.*, "FERC—not the court of appeals—found the key fact here, namely that petitioner had not met his burden of proof," Br. Opp. at 18; "FERC *itself* determined, both initially and on rehearing . . . that petitioner did not prove by a preponderance of the evidence that the contractual language and extrinsic evidence supported his interpretation," *id.* at 2; "[t]he *only* factual finding that ultimately mattered in this case—and one the agency reaffirmed repeatedly . . . was that petitioner failed to prove his position by a preponderance of the evidence." *Id.* at 16.

argues, that Scarth did not meet his burden of proof, then Scarth, rather than NICOR, would have been the petitioner below.

B. NICOR claims that the Fifth Circuit did not misapply the substantial evidence standard "because it accepted . . . every single one of the agency's factual findings." Br. Opp. at 16. This simply is not true. FERC below properly applied the factual inferences established in Opinion 77. *See* Pet. at 13-20. Rather than accepting such factual findings, the Fifth Circuit invalidated Opinion 77, but without making the requisite finding that FERC's Opinion 77 factual inferences were not based on substantial evidence.[8]

The Fifth Circuit invalidated a number of other factual findings of FERC (without the requisite substantial evidence findings, and therefore did not "accept[] *all* of FERC's factual findings)." Br. Opp. at 2. Thus, the court failed to give conclusive weight, as required by the substantial evidence test, to the FERC findings that (a) NICOR did not object to congressionally-established rates (App. 99a); (b) NICOR's witnesses conceded "there is no evidence that . . . a 'cost-based' limitation" was ever expressed in negotiations (App. 60a, 79a); (c) "the producers

---

[8]Indeed, the court acknowledged that in Opinion 77 FERC found that by contract references to the NGA or its "just and reasonable" standard, supplemented by the phrase "or successor statutory authority" or similar words, "the parties commit their contractual destiny to a change in the statutory scheme and give advance acceptance to the outcome of the legislative process." App. at 7a, n.3 (*quoting* Opinion 77). Rather than "accepting" such factual findings, the Fifth Circuit held invalid Opinion 77, but failed to make the requisite substantial evidence findings.

intended to get the highest lawful rate" (App. 91a, n.23; 58a); and (d) NICOR in the contracts *agreed to pay* "a non-cost-based" rate. App. 91a-92a, n.25. The Fifth Circuit's ultimate ruling cannot be harmonized with these factual findings of FERC. *See also* Pet. at 17 n.12.

CONCLUSION

Wherefore Scarth prays that a writ of *certiorari* issue to review the judgment of the Fifth Circuit.

Respectfully submitted,

BERNARD A. FOSTER, III
Counsel of Record

WILLIAM R. MAPES, JR.
DEBORAH A. CARPENTIER
ROSS, MARSH & FOSTER
1401 H Street, N.W.
Washington, D.C. 20005-2110
(202) 822-8888

Counsel for Petitioners

December 18, 1995

APPENDIX

Excerpt (pages 13-14) from Petition of Intervenor Robert W. Scarth, *et al.* for Rehearing *En Banc* filed in *NICOR Exploration Co. v. FERC*, Fifth Cir. No. 94-40246.

E. The Court *En Banc* Should Reconsider The Appropriate Standard Of Reviewing FERC Interpretation Of ARCs

The Panel concluded that FERC's contract interpretation is a matter of law that is not entitled to deference, but instead *de novo* review (Op. at 11). Scarth submits that the Court *en banc* should reconsider this standard of review. First, deference is appropriate under *Chevron U.S.A., Inc. v. NRDC*, 467 U.S. 837, 843 (1984), which held that a court must defer to an agency's ruling on a statutory interpretation question of law if it is based on a permissible construction. The same rationale applies here. Tariffs "are binding contracts," and "[t]he task of interpretation of tariffs . . . is akin to the task of statutory interpretation . . . [both involving] mainly questions of law." *Coca-Cola Co. v. Atchison, T & S.F. Ry.*, 608 F.2d 213, 219 (5th Cir. 1979). Scarth's contracts with NICOR are its FERC tariffs. In view of *Chevron* and the rationale of *Coca-Cola*, deference is compelled of agency interpretations of both statutes *and* contracts.[12]

---

[12]Other circuits apply *Chevron* to contract interpretation or otherwise provide deference to agency legal conclusions. *See, e.g., First Indep. Group, Inc. v. SEC*, 37 F.3d 30, 32 (2d Cir. 1994); *Electromation, Inc. v. NLRB*, 35 F.3d 1148, 1155 (7th Cir. 1994); *National Fuel Gas Supply*

(continued...)

Deference also is appropriate in view of FERC's expertise. In *United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. 103, 114 (1958) [hereinafter *Memphis*], the Court held that the contract interpretation issue "involves matters peculiarly within the area of the Commission's special competence and as to which we could hardly be aided by a further examination of the record by the Court of Appeals." Scarth recognizes that *Pennzoil I* held in a footnote that the reference in *Memphis* to FERC's "special competence" does not mean that FERC "is more competent than courts in this area." 645 F.2d at 386 n.53. *Scarth requests reconsideration of this holding*. Scarth submits that the reference in *Memphis* to "peculiarly within the area of the Commission's special competence" can only reasonably be interpreted to mean "greater than" court competence.

Here, FERC exercised its "special competence" in interpreting ARCs that were required to take into account a FERC regulation [18 C.F.R. § 154.93 (b-1)], that limited the permissible language at the risk of FERC rejection. 18 C.F.R. § 157.25, Exh. B. Moreover, FERC's Opinion 77, issued after *Pennzoil I*, relied upon the "record developed in the [Order 23] rulemaking proceedings" and "the accumulated experience of the Commission in dealing with . . . [ARCs] in a variety of settings," and noted that ARCs "were a product of the then prevailing [NGA] regulatory scheme." 10 FERC at 61,396. FERC applied its expert

---

[12](...continued)
Corp. v. FERC, 811 F.2d 1563, 1570 (D.C. Cir.), *cert. denied*, 484 U.S. 869 (1987); *Consolidated Gas Supply Corp. v. FERC*, 745 F.2d 281, 291 (4th Cir. 1984); *cert. denied*, 472 U.S. 1008 (1985).

knowledge of the "prevailing regulatory scheme" here, and found that, during the contract negotiations (1969-1970), there was "no specific FPC-established ceiling rates" for gas under the contracts, and in the 1970 contracts NICOR *agreed to pay* "a non-cost-based prevailing 'in line' rate" that exceeded the proposed rates contemporaneously found by an ALJ to be "just and reasonable." 63 FERC at 61,181 n.14; 66 FERC at 61,773 n.25.